

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

**APPLICATION OF KENTUCKY POWER COMPANY D/B/A)
AMERICAN ELECTRIC POWER FOR APPROVAL OF AN)
AMENDED COMPLIANCE PLAN FOR PURPOSES) CASE No. 2002-00169
OF RECOVERING THE COSTS OF NEW AND ADDITIONAL)
POLLUTION CONTROL FACILITIES AND TO AMEND ITS)
ENVIRONMENTAL SURCHARGE TARIFF)**

**DIRECT TESTIMONY
AND EXHIBITS
OF
LANE KOLLEN**

**ON BEHALF OF THE
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.**

**J. KENNEDY AND ASSOCIATES, INC.
ROSWELL, GEORGIA**

JANUARY 2003

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DIRECT TESTIMONY OF LANE KOLLEN

I. QUALIFICATIONS AND SUMMARY

1 **Q. Please state your name and business address.**

2

3 A. My name is Lane Kollen. My business address is J. Kennedy and Associates, Inc.
4 ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia
5 30075.

6

7 **Q. What is your occupation and by whom are you employed?**

8

9 A. I am a utility rate and planning consultant holding the position of Vice President and
10 Principal with the firm of Kennedy and Associates.

J. Kennedy and Associates, Inc.

1 **Q. Please describe your education and professional experience.**

2

3 A. I earned a Bachelor of Business Administration in Accounting degree from the
4 University of Toledo. I also earned a Master of Business Administration degree from
5 the University of Toledo. I am a Certified Public Accountant, with a practice license,
6 and a Certified Management Accountant.

7

8 I have been an active participant in the utility industry for more than twenty-five years,
9 both as an employee and as a consultant. Since 1986, I have been a consultant with
10 Kennedy and Associates, providing services to state government agencies and large
11 consumers of utility services in the ratemaking, financial, tax, accounting, and
12 management areas. From 1983 to 1986, I was a consultant with Energy Management
13 Associates, providing services to investor and consumer owned utility companies. From
14 1976 to 1983, I was employed by The Toledo Edison Company in a series of positions
15 encompassing accounting, tax, financial, and planning functions.

16

17 I have appeared as an expert witness on accounting, finance, ratemaking, and planning
18 issues before regulatory commissions and courts at the federal and state levels on more
19 than one hundred occasions. I have developed and presented papers at various industry
20 conferences on ratemaking, accounting, and tax issues. I have testified before the

1 Kentucky Public Service Commission on numerous occasions, including environmental
2 cost recovery (“ECR”) proceedings involving Kentucky Power Company (“KPC” or
3 “Company”), Louisville Gas and Electric Company (“LGE”), Kentucky Utilities
4 Company (“KU”), and Big Rivers Electric Corporation. My qualifications and
5 regulatory appearances are further detailed in my Exhibit ___(LK-1).

6
7 **Q. On whose behalf are you testifying?**

8
9 A. I am testifying on behalf of the Kentucky Industrial Utility Customers, Inc. (“KIUC”), a
10 group a large users taking electric service on the KPC system.

11
12 **Q. What is the purpose of your testimony?**

13
14 A. The purpose of my testimony is to address the Company’s proposed recovery of 2002
15 environmental compliance plan costs through the ECR surcharge mechanism.

1 **Q. Please summarize your testimony.**

2

3 A. The Company's proposed 2002 Compliance Plan ("Plan") is not reasonable and cost
4 effective, nor does it reflect actual costs, three requirements established by the ECR
5 statute, KRS 278.183. The Plan will result in excessive cost recovery by KPC to the
6 detriment of its ratepayers unless it is modified.

7

8 First, the Company's proposal to install the Big Sandy 2 selective catalytic reduction
9 ("SCR") is premature by 13 months and should be modified to reflect a May 31, 2004
10 installation date. There is no economic or financial rationale for installing the SCR by
11 May 1, 2003 rather than the required May 31, 2004 date. The Company performed no
12 economic studies to demonstrate that early compliance was cost-effective.

13

14 The Company's Plan for early compliance will result in net harm to ratepayers through
15 the ECR. On a total Company basis, the net harm will be in excess of \$20 million,
16 consisting of nearly \$25 million (\$23 million for first 12 months) in increased costs
17 during the 13 month early compliance period, offset by approximately \$5 million in
18 sales proceeds for the early reduction credits ("ERCs"), assuming the ERCs actually are
19 sold and at the prices estimated by KPC. In contrast to the harm visited upon ratepayers
20 from early compliance, the Company itself could avoid financial harm through delay of

1 the construction expenditures and the related financing requirements as well as
2 continued accrual of allowance for funds used during construction (“AFUDC”) on
3 amounts already expended.

4
5 The Commission should modify the Company’s Plan to reflect an in-service date of
6 May 31, 2004 for the Big Sandy 2 SCR for ECR cost recovery purposes. In the event
7 the Company does proceed with the early compliance schedule and it acquires ERCs,
8 then the Company should be allowed to retain the revenues from the sale of those ERCs
9 to offset its costs incurred, but not recovered through the ECR, during the early
10 compliance period.

11
12 Second, the Company’s requested return on common equity is excessive and should be
13 reduced to a reasonable level. KIUC witness Mr. Richard Baudino addresses and
14 recommends a reasonable return on common equity in this proceeding that is
15 substantially less than the Company’s requested 12.75% and less than the existing
16 authorized 11.50%. The authorized return on common equity in this proceeding will
17 affect not only the Company’s 2002 Compliance Plan ECR rate base investment, but
18 also the return on the Company’s other ECR rate base investment, authorized in
19 conjunction with the prior compliance plan.

20

1 Third, the Company's proposed overall return is excessive and based on hypothetical
2 costs rather than actual costs. The overall return should be reduced to the reasonable
3 and actual cost by incorporating in the capital structure and component costs the short
4 term debt associated with factoring its accounts receivable. The Commission already
5 has determined for Louisville Gas and Electric Company ("LGE") and Kentucky
6 Utilities Company ("KU") that accounts receivable financing should be reflected as
7 short term debt in the overall rate of return applied to ECR rate base investment. Unlike
8 KPC, both LGE and KU agree with this determination by the Commission. In addition,
9 KPC has agreed that other forms of short term debt should be reflected in the overall
10 rate of return applied to ECR rate base investment. The accounts receivable financing
11 should be reflected in the overall return applied not only to the Company's 2002
12 Compliance Plan ECR rate base investment, but also the overall return on the
13 Company's other ECR rate base investment, authorized in conjunction with the prior
14 compliance plan.

15
16 Fourth, the Company's plan results in excessive and unreasonable costs because it
17 includes the cost of a hypothetical standalone reverse osmosis water system upgrade
18 rather than a proportional allocation of the actual costs of the system installed. The
19 Commission should reject this attempt to over-allocate costs to the ECR, and instead,
20 limit cost recovery to a proportional allocation of actual costs.

1 Finally, the Company's Plan will result in excessive and unreasonable costs due to the
2 proposal to allocate to Kentucky retail ratepayers nearly the entirety of the ECR revenue
3 requirement currently allocated to associated utilities. The Commission should reject
4 this proposal as it has repeatedly in the past. The total revenues methodology was
5 established for KPC by the Commission in Case No. 96-489, upheld by the Franklin
6 Circuit Court on appeal, and confirmed by the Commission in Case No. 2000-107. The
7 Commission has adopted and applied the total revenues methodology since ECR
8 surcharges were adopted for KPC, LGE, KU, and Big Rivers.

9

1 **II. BIG SANDY 2 SCR**

2

3 **Q. How does the Company's proposed timing of the Big Sandy 2 SCR project**
4 **compare to the required compliance date?**

5

6 A. The Company plans to complete the Big Sandy 2 SCR project in May 2003 and to
7 include it in the ECR the month following the in-service date. The May 2003 in-service
8 date was initially based upon the May 1, 2003 SIP Call and 126 Petition rule
9 requirements compliance date as described in the testimony of Mr. McManus. Nearly a
10 year ago, the required compliance date was delayed by 13 months to May 31, 2004.
11 However, the Company proceeded with the May 2003 date, despite the delay in the
12 required compliance date.

13

14 **Q. Is the Company's plan to install the Big Sandy 2 SCR early reasonable and cost-**
15 **effective?**

16

17 A. No. The Company's plan is not cost-effective and consequently, the related costs prior
18 to the required compliance date are excessive and unreasonable, and should not be
19 recovered through the ECR. The net costs of early compliance include the costs of

1 compliance offset by ERCs. ERC's are additional allowances granted to the Company
2 for early compliance, which the Company is entitled to sell to other parties.
3

4 I have quantified the first year total Company ECR revenue requirement for the Big
5 Sandy 2 SCR at \$22.7 million, based upon the projected net rate base, requested return,
6 and operating expenses reflected in Mr. Wagner's Exhibit EK W-2. I have extrapolated
7 the first year revenue requirement to quantify the 13 month early compliance period
8 revenue requirement at \$24.6 million. The Company has projected the proceeds from
9 selling the ERCs at \$4.5 million, according to its response to KIUC-1-31.
10

11 Thus, the total Company net cost of early compliance is \$20.1 million (\$24.6 million
12 less \$4.5 million). The projected value of the ERCs does not come close to covering the
13 cost of early compliance. Consequently, it cannot be reasonable and cost-effective to
14 impose this net cost on ratepayers.
15

16 **Q. Has the Company provided any demonstration in this proceeding that Big Sandy 2**
17 **NOx early compliance is cost-effective?**
18

19 **A.** No. The Company has provided no economic studies that demonstrate early compliance
20 is cost effective. Staff-1-15(d) requested the Company to "Provide any present value

1 analysis Kentucky Power has performed of the costs to ratepayers of its plan to control
2 NOx emissions prior to the compliance date, netted against the value of acquired ERCs,
3 compared to installing the NOx technologies and charging ratepayers for their costs
4 based solely on meeting the compliance deadline.” In response, the Company stated that
5 “A present value analysis of the cost of early compliance has not been done.”
6

7 In addition, KPC failed to address the cost-effectiveness of early compliance through its
8 witnesses, except to state that revenues from the sales of ERCs, if any, would be utilized
9 to offset the ECR revenue requirements.
10

11 Perhaps the Company realized that there was no economic justification to impose total
12 Company net costs of \$20.1 million on ratepayers and that no credible economic study
13 would demonstrate otherwise. In any event, the Company has failed to demonstrate that
14 early compliance is cost-effective.
15

16 **Q. Would the Company itself have been harmed if it delayed the Big Sandy 2 SCR by**
17 **13 months?**
18

19 **A.** No. The Company itself could avoid financial harm by delaying the construction
20 expenditures and the related financing. It would have been able to continue to accrue

1 AFUDC on the amounts previously expended. Thus, for the Company, such a delay
2 would have been a mere timing difference with no financial harm, while for the
3 ratepayers the harm is not merely a timing difference, but rather, is permanent.

4
5 **Q. The Company has offered to offset the Big Sandy 2 SCR ECR revenue requirement**
6 **with the proceeds from the sale of ERCs, if indeed any are sold. Please respond.**

7
8 A. This offer does not make early compliance reasonable and cost-effective, as previously
9 discussed. This offer only mitigates the harm to ratepayers. Nevertheless, if the
10 Commission authorizes ECR recovery prior to the required compliance date, then it
11 should accept the Company's offer, subject to review of the actual transaction(s).
12 However, Kentucky Power has made no commitment actually to sell the ERCs.
13 Consequently, the Commission should modify KPC's compliance plan to require KPC
14 to sell the ERCs that are unnecessary for KPC compliance. The sales proceeds then
15 should be amortized through the ECR over a 12 month period. In addition, the
16 unamortized sales proceeds should be utilized to reduce the ECR rate base during the
17 amortization period.

18
19 **Q. How should the Commission proceed on this issue?**
20

1 A. Pursuant to the ECR statute, the Commission only can include actual costs that are
2 reasonable and cost-effective. During the early compliance period, the Company's
3 requested costs are not reasonable or cost-effective. As such, the Company should not
4 be authorized ECR recovery for the Big Sandy 2 SCR costs until May 31, 2004.
5 Nevertheless, if the Commission does authorize ECR recovery for the Big Sandy 2 SCR
6 costs prior to May 31, 2004, then it should require the Company to sell the ERCs and to
7 amortize the sales proceeds through the ECR over 12 months, with the unamortized
8 proceeds utilized as a rate base reduction during the amortization period.

9
10
11
12

1 on common equity from 11.50% to 12.75% on the projects previously authorized in
2 Case No. 96-489. Consequently, the revenue requirement and the related 7.8% increase
3 to ratepayers cited by the Company in its testimony actually will be greater if the
4 Company's return on equity is increased from 11.50% to 12.75%.

5
6 **Q. Does KPC utilize short term debt financing?**

7
8 A. Yes. KPC utilizes various forms of short term debt financing, including borrowings
9 from the AEP Money Pool and factoring its accounts receivables.

10
11 **Q. Please describe KPC's accounts receivable financing.**

12
13 A. I have attached KPC's description of the accounts receivable financing provided in
14 response to Staff-1-13 as my Exhibit ___(LK-2). KPC factors its accounts receivable to
15 AEP Credit, Inc., an affiliate. The cost to KPC of factoring its receivables includes a
16 financing cost based upon AEP Credit, Inc.'s cost of financing, which consists mostly of
17 low cost short term debt (95%) representing borrowings from banks and through
18 commercial paper conduits. The financing cost paid by KPC also includes a return on
19 AEP Credit, Inc.'s common equity (5%) at KPC's authorized return on common equity.
20 The cost of the accounts receivable financing is 2.88% at November 30, 2002. I

1 computed this cost based upon the Company's supplemental responses to Staff-2-6b and
2 6e.

3

4 **Q. Does the Company agree that short term debt should be reflected in the overall**
5 **rate of return applied to ECR rate base investment?**

6

7 A. Yes. The Company agreed that short term debt should be included in the capitalization
8 for purposes of the ECR in response to KIUC-1-2. However, in response to Staff
9 discovery on this issue, KPC stated that it does not agree that accounts receivable
10 financing should be reflected in the overall rate of return for purposes of the ECR.

11

12 **Q. Should the Company's accounts receivable financing be included in the overall**
13 **rate of return utilized for ECR purposes?**

14

15 A. Yes. The accounts receivable financing is one of the lowest cost forms of financing
16 utilized to KPC. There is no valid reason why the accounts receivable financing should
17 be ignored for ECR purposes. The accounts receivables amounts factored by KPC to
18 AEP Credit, Inc. are customer receivables, which include the receivables resulting from
19 the ECR.

20

1 **Q. Has the Commission already made a determination that accounts receivable**
2 **financing is properly included in the overall rate of return utilized for ECR**
3 **purposes?**

4
5 A. Yes. The Commission already has made a determination on this issue in LGE and KU
6 ECR Case Nos. 2000-386 and 2000-439. In those proceedings, LGE, KU, and KIUC
7 all agreed that the accounts receivable financing should be reflected in the overall rate of
8 return applied to the net ECR rate base. In the LGE and KU Petition for
9 Reconsideration in those proceedings, LGE and KU stated that “LG&E and KU agree
10 with KIUC on this point and ask the Commission to modify the April 18, 2001 Orders to
11 specifically include the accounts receivable financing in the calculation of the
12 environmental surcharge capitalization structure.”

13
14 The Commission’s Orders on Reconsideration in the LGE and KU proceedings stated
15 that “After consideration of the responses and arguments of KIUC and LG&E [KU], the
16 Commission finds that it is reasonable to include LG&E’s [KU’s] accounts receivable
17 financing in the environmental surcharge capital structure as a separate component and
18 reflected as such when calculating the weighted cost of capital.”

19

1 Thus, KPC stands alone in its opposition to including the accounts receivable financing
2 in the overall rate of return applied to ECR net investment. Although KPC
3 acknowledged in response to Staff-2-6 in this proceeding that it had been unaware that
4 the Commission already decided this issue, KPC now has decided that it will directly
5 oppose the Commission's precedent.

6
7 The Commission should ensure that its prior determination on this issue is applied
8 consistently to all jurisdictional utilities that utilize this form of financing.

9
10 **Q. Why does KPC oppose the inclusion of accounts receivable financing in its overall**
11 **rate of return for ECR purposes?**

12
13 A. In response to Staff-2-6, the Company stated two reasons for its opposition. The first
14 reason was that its ECR included no cash working capital amount, and thus "no
15 reduction to working capital was necessary." The second reason was that ratepayers will
16 receive the benefit of the lower cost financing in future base rate proceedings because
17 KPC's balance sheet capitalization is lower due to the factoring of its receivables and
18 the displacement of financing that otherwise would have been required.

1 **Q. Please respond to the Company's argument that "no reduction to working capital**
2 **was necessary" since no cash working capital was included in the ECR.**

3

4 A. The Company's reason begs the issue itself by identifying another issue in its proposed
5 ECR recovery. The first issue is whether the lower cost accounts receivable financing
6 should be reflected in the overall return applied to the ECR rate base or whether the
7 Company should be allowed to retain the savings from this form of financing for some
8 indefinite period. I already have addressed that issue.

9

10 The second issue is whether the Commission should include an amount for cash
11 working capital in the ECR rate base. Although the Company has not requested
12 authorization to include cash working capital in the ECR rate base, it would be
13 appropriate for the Commission to modify the Company's proposed recovery to reflect
14 cash working capital. For this purpose, the Commission should employ the one-eighth
15 of O&M expense formula applied to the ECR O&M expense. The Commission
16 consistently has used the one-eighth of O&M expense formula to quantify cash working
17 capital for the utilities in the state. The Commission utilized this formula for KPC, LGE
18 and KU in their last base rate proceedings and currently utilizes this formula for LGE
19 and KU in their ECRs.

20

1 **Q. Please respond to the Company’s argument that ratepayers will receive the benefit**
2 **when base rates are reset at some time in the future because KPC’s balance sheet**
3 **capitalization is lower due to the factoring of its receivables.**

4
5 A. Fundamentally, ratepayers are harmed by the Company’s position on this issue. The
6 ratepayers should not have to wait indefinitely for a base rate proceeding to obtain the
7 benefit of the savings allocable to the net ECR rate base investment, particularly since a
8 portion of the receivables financing is directly related to the ECR. KPC has admitted
9 that ratepayers are entitled to the savings resulting from the lower cost form of
10 financing. Thus, there is no valid rationale, and KPC has offered none, for selectively
11 denying ratepayers the savings achieved from this lower cost form of financing through
12 the ECR on a timely basis.

13
14 The methodology approved by the Commission for the ECR revenue requirement is
15 based upon a return on rate base, not a return on capitalization as is the case for base
16 ratemaking purposes. There is no reduction in the ECR rate base to reflect the reduction
17 in capitalization achieved by the accounts receivable financing. Thus, if the accounts
18 receivable financing is not reflected in the overall rate of return for ECR purposes, then
19 ratepayers receive no recognition of the lower actual costs associated with financing the

1 ECR investment unless and until there is a base rate proceeding and base rates are
2 changed.

3
4 **Q. Is the Company's proposal to exclude accounts receivable financing from the**
5 **overall return on net ECR investment consistent with the statutory requirement**
6 **that only actual costs are allowed recovery through the ECR?**

7
8 A. No. The ECR statute provides for the recovery of reasonable and actual costs, no more
9 and no less. It is not reasonable to exclude lower cost financing specifically tied to ECR
10 receivables simply because the utility wants to retain those savings until some unknown
11 time in the future.

12
13 In addition, the Company's requested overall return does not reflect its actual costs as
14 required by the ECR statute, but rather reflects hypothetical costs that are in excess of
15 actual costs. The Company does not dispute that its actual costs are lower due to the
16 accounts receivable financing. However, the Company's proposal artificially inflates its
17 requested ECR overall return by selectively excluding this financing from its short term
18 debt and retaining the entirety of the actual savings related to the ECR portion of its
19 receivables indefinitely until the effective date of some future base ratemaking
20 proceeding.

1
2
3

1 **IV. REVERSE OSMOSIS WATER SYSTEM**

2

3 **Q. Please describe the Company's request for recovery of the costs associated with**
4 **the Big Sandy 2 SCR new water treatment system.**

5

6 A. The Company has included the hypothetical cost of a Big Sandy 2 SCR standalone
7 water treatment system rather than a proportional allocation of the actual costs of a new
8 system sized at four times the requirements of the SCR. The new water treatment
9 system was designed to handle a flow of 120 gpm rather than the 30 gpm required for
10 the SCR alone and is scheduled to enter service concurrently with the SCR in May 2003.
11 The Company estimates the hypothetical cost of a Big Sandy 2 SCR standalone system
12 at \$0.665 million compared to the total system cost of \$1.333 million, or one half of the
13 total system cost.

14

15 **Q. Is the Company's proposed use of a hypothetical cost for a standalone water**
16 **treatment system appropriate for ECR recovery purposes?**

17

18 A. No. First, the ECR statute requires the Commission to use actual costs, not hypothetical
19 costs. Second, it is unreasonable to allocate one half of the system cost to the SCR
20 when the SCR requires only one fourth of the capacity.

1 **Q. How should the Commission proceed on this issue?**

2

3 **A.** The Commission should reject the Company's hypothetical standalone system cost
4 and instead utilize a one fourth proportional allocation of actual costs based on the
5 SCR's capacity requirements compared to the total capacity of the system.

6

7

1 utilities. In Case No. 2000-107, the Company relied upon the same arguments it raised
2 in the initial proceeding. The Commission again rejected those arguments.

3
4 I have replicated the relevant sections of the Commission's Order in Case No. 96-489 as
5 my Exhibit___(LK-3), the relevant sections of the Franklin Circuit Court's Opinion and
6 Order as my Exhibit___(LK-4), and the relevant sections of the Commission's Order in
7 Case No. 2000-107 as my Exhibit___(LK-5). These Orders specifically addressed each
8 of the arguments raised by the Company in Case Nos. 96-489 and 2000-107, the
9 arguments in opposition to the Company raised by the parties, including KIUC, and the
10 Commission's and Court's rationale for rejecting the Company's proposal in those
11 proceedings. Nevertheless, I will respond to certain of the specific arguments again
12 raised by the Company in this proceeding.

13
14 **Q. The Company claims that the Commission's allocation methodology results in**
15 **"trapped costs" because it cannot recover the allocated environmental costs from**
16 **its associated utilities. Please respond.**

17
18 A. The Commission extensively addressed this very issue in its Case No. 2000-107 Order,
19 both for revenues due to sales to associated utilities and non-associated utilities. The
20 Commission addressed the issue of the recovery of environmental costs from retail

1 jurisdictional ratepayers and concluded that it did not have a responsibility to ensure
2 recovery of the residual costs through the AEP Interconnection Agreement from
3 associated utilities or from other regulatory jurisdictions. In its Case No. 2000-107
4 Order, the Commission stated the following:

5
6 **The Commission is not persuaded by Kentucky Power's arguments that the**
7 **use of the revenue method creates an inconsistency with the costing**
8 **provisions of the AEP Pool Agreement. Because of the requirements of the**
9 **AEP Pool Agreement, the environmental surcharge mechanism does**
10 **include costs associated with AEP's Rockport, Indiana and Gavin, Ohio**
11 **generating units. However, the AEP Pool Agreement does not dictate how**
12 **the Commission allocates the environmental costs to retail ratepayers under**
13 **the surcharge mechanism.**

14
15 **Kentucky Power's contention that no other AEP operating company should**
16 **be allocated any of its fixed environmental costs because Kentucky Power is**
17 **not a capacity surplus company is irrelevant. This Commission has**
18 **exclusive jurisdiction over Kentucky Power's retail rates, including its**
19 **environmental surcharge. Kentucky Power's fixed and variable**
20 **environmental costs must be allocated to the appropriate cost-causer. To**
21 **the extent that Kentucky Power makes sales to other AEP affiliates, it is**
22 **clearly inappropriate for the environmental costs associated with those sales**
23 **to be recovered through a surcharge on Kentucky retail ratepayers,**
24 **regardless of whether Kentucky Power is a surplus member of the AEP**
25 **power pool. While Kentucky Power claims that it pays no fixed**
26 **environmental costs on purchases from AEP non-surplus members,**
27 **Kentucky Power has provided no analysis of the costs incorporated in the**
28 **price it pays for purchases from any other AEP operating company,**
29 **whether surplus or non-surplus.**

30
31 **The Commission finds that none of the arguments offered by Kentucky**
32 **Power support a change in the jurisdictional allocation approach and,**
33 **therefore, the revenue method should continue to be utilized. We agree**
34 **with the AG that Kentucky Power's arguments concerning the appropriate**

1 **cost-causer are essentially the same as presented, and the Commission**
2 **considered and rejected, in Case No. 96-489. Kentucky Power’s concerns**
3 **over the interaction of the environmental surcharge mechanism with its**
4 **Sales Clause indicate that if there is a problem, it lies within the Sales**
5 **Clause and does not constitute justification for a change in the allocation**
6 **approach. We further agree with the arguments of KIUC, which notes that**
7 **significant levels of Kentucky Power’s sales are made to off-system**
8 **customers. Under these conditions, it is neither appropriate nor reasonable**
9 **to allocate a greater share of Kentucky Power’s environmental costs to its**
10 **jurisdictional ratepayers, and in effect subsidize off-system sales customers.**
11

12 As the Commission noted, it is not its responsibility to ensure that costs properly
13 allocated to the cost causers are recoverable by the associated utilities. If such allocated
14 costs are “trapped,” then it is due solely to the fact that the Company and AEP have not
15 allocated these costs to the associated utilities through the AEP Interconnection
16 Agreement or sought to recover those costs in its other retail and wholesale jurisdictions.

17
18 **Q. Does AEP have the discretion to modify the “energy transfer prices” among the**
19 **associated utilities to include costs such as the allocated ECR costs, pursuant to the**
20 **recently implemented three member AEP Interconnection Agreement?**

21
22 **A. Yes. The AEP Interconnection Agreement provides AEP Service Corporation the**
23 **discretion to determine the costs that are recoverable by the seller from other associated**
24 **utilities. Such costs could include those KPC environmental costs allocated to**
25 **associated utilities pursuant to the Commission’s current ECR total revenues**

1 methodology. Service Schedule A to the Interconnection Agreement addresses energy
2 sales and transfer prices among the associated utilities. Service Schedule A provides
3 that the purchaser must pay the seller the seller's "incremental costs" plus one half of the
4 difference between the purchaser's decremental costs and the seller's incremental costs.
5 Incremental costs are defined in Section 1.11 of the Interconnection Agreement, and are
6 subject to the discretion of the Agent, which is AEP Service Corporation. Section 1.11
7 states the following:

8
9 **Incremental Cost means any costs incurred by an Operating Company**
10 **solely by reason of its provision of an incremental amount of energy to**
11 **supply to another Operating Company, including but not limited to costs**
12 **for fuel, reactive power, labor, operation, maintenance, start-up, fuel**
13 **handling, taxes, emission allowances, and transmission and ancillary service**
14 **charges and losses, and charges for any power and energy purchased that is**
15 **reasonably allocated by the Agent to such supply, and other expenses**
16 **incurred that would not have been incurred if the supply had not been**
17 **provided to the other Operating Company.**
18

19 It is clear that the Agent has significant discretion to determine the components of cost
20 included in the seller's incremental costs for purposes of Service Schedule A and
21 without explicit regulatory authorization.

22
23 **Q. Are the costs allocated to the associated utilities pursuant to the Commission's**
24 **current methodology incremental costs associated with those sales?**

1 A. Yes. There are no costs allocated to associated utilities if there are no sales to associated
2 utilities. Similarly, there are no costs allocated to non-associated utilities if there are no
3 sales to non-associated utilities. If there are no such sales, nearly the entirety of the
4 Company's ECR environmental costs are recovered from retail ratepayers. In fact, that
5 situation may occur during the extended Big Sandy 2 outage to install the SCR.
6 Consequently, these costs indeed are incremental to sales to associated utilities and
7 could be considered as such pursuant to the IA without explicit regulatory authorization.

8

9 **Q. Does the IA contain a provision for amending the Service Schedules should that be**
10 **necessary?**

11

12 A. Yes. Although it is unnecessary to amend the Service Schedules to determine the
13 components of cost included in the seller's incremental costs, Section 8.1 of the
14 Interconnection Agreement does authorize amendments to the Service Schedules,
15 subject to the agreement of the parties and the receipt of any necessary regulatory
16 authorization. Section 8.1 states:

17

18 **It is understood and agreed that all such Service Schedules are intended to**
19 **establish an equitable sharing of costs and/or benefits among the Parties,**
20 **and that circumstances may, from time to time, require a reassessment of**
21 **the relative benefits and burdens of this Agreement, or of the methods used**
22 **to apportion benefits and burdens of the Service Schedules. Upon a**

1 **recommendation of the Operating Committee and agreement among the**
2 **Parties, any of the Service Schedules may be amended as of any date agreed**
3 **to by the Parties, subject to receipt of any necessary regulatory**
4 **authorizations.**
5

6 **Q. How should the Commission proceed on this allocation issue?**

7
8 **A. The Commission should reject the Company's proposal to force jurisdictional ratepayers**
9 **to subsidize sales to associated utilities. If Kentucky Power and its associated utilities**
10 **believe there are trapped environmental costs incurred by the AEP regulated utilities that**
11 **are not properly addressed by the Interconnection Agreement, then they should resolve**
12 **those recovery issues among themselves in the manner prescribed by the Interconnection**
13 **Agreement.**

14
15 **Q. Does this complete your testimony?**

16
17 **A. Yes.**

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY POWER COMPANY D/B/A)	
AMERICAN ELECTRIC POWER FOR APPROVAL OF AN)	
AMENDED COMPLIANCE PLAN FOR PURPOSES)	CASE No. 2002-00169
OF RECOVERING THE COSTS OF NEW AND ADDITIONAL)	
POLLUTION CONTROL FACILITIES AND TO AMEND IT)	
ENVIRONMENTAL SURCHARGE TARIFF)	

<p>EXHIBITS</p> <p>OF</p> <p>LANE KOLLEN</p>

ON BEHALF OF THE
KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

J. KENNEDY AND ASSOCIATES, INC.
ROSWELL, GEORGIA

JANUARY 2003

EXHIBIT ____ (LK-1)

RESUME OF LANE KOLLEN, VICE PRESIDENT

EDUCATION

University of Toledo, BBA
Accounting

University of Toledo, MBA

PROFESSIONAL CERTIFICATIONS

Certified Public Accountant (CPA)

Certified Management Accountant (CMA)

PROFESSIONAL AFFILIATIONS

American Institute of Certified Public Accountants

Georgia Society of Certified Public Accountants

Institute of Management Accountants

More than twenty-five years of utility industry experience in the financial, rate, tax, and planning areas. Specialization in revenue requirements analyses, taxes, evaluation of rate and financial impacts of traditional and nontraditional ratemaking, utility mergers/acquisition diversification. Expertise in proprietary and nonproprietary software systems used by utilities for budgeting, rate case support and strategic and financial planning.

RESUME OF LANE KOLLEN, VICE PRESIDENT

EXPERIENCE

1986 to

Present:

J. Kennedy and Associates, Inc.: Vice President and Principal. Responsible for utility stranded cost analysis, revenue requirements analysis, cash flow projections and solvency, financial and cash effects of traditional and nontraditional ratemaking, and research, speaking and writing on the effects of tax law changes. Testimony before Connecticut, Florida, Georgia, Indiana, Louisiana, Kentucky, Maine, Minnesota, North Carolina, Ohio, Pennsylvania, Tennessee, Texas, and West Virginia state regulatory commissions and the Federal Energy Regulatory Commission.

1983 to

1986:

Energy Management Associates: Lead Consultant.

Consulting in the areas of strategic and financial planning, traditional and nontraditional ratemaking, rate case support and testimony, diversification and generation expansion planning. Directed consulting and software development projects utilizing PROSCREEN II and ACUMEN proprietary software products. Utilized ACUMEN detailed corporate simulation system, PROSCREEN II strategic planning system and other custom developed software to support utility rate case filings including test year revenue requirements, rate base, operating income and pro-forma adjustments. Also utilized these software products for revenue simulation, budget preparation and cost-of-service analyses.

1976 to

1983:

The Toledo Edison Company: Planning Supervisor.

Responsible for financial planning activities including generation expansion planning, capital and expense budgeting, evaluation of tax law changes, rate case strategy and support and computerized financial modeling using proprietary and nonproprietary software products. Directed the modeling and evaluation of planning alternatives including:

Rate phase-ins.
Construction project cancellations and write-offs.
Construction project delays.
Capacity swaps.
Financing alternatives.
Competitive pricing for off-system sales.
Sale/leasebacks.

J. KENNEDY AND ASSOCIATES, INC.

RESUME OF LANE KOLLEN, VICE PRESIDENT

CLIENTS SERVED**Industrial Companies and Groups**

Air Products and Chemicals, Inc.	Lehigh Valley Power Committee
Airco Industrial Gases	Maryland Industrial Group
Alcan Aluminum	Multiple Intervenors (New York)
Armco Advanced Materials Co.	National Southwire
Armco Steel	North Carolina Industrial
Bethlehem Steel	Energy Consumers
Connecticut Industrial Energy Consumers	Occidental Chemical Corporation
ELCON	Ohio Industrial Energy Consumers
Enron Gas Pipeline Company	Ohio Manufacturers Association
Florida Industrial Power Users Group	Philadelphia Area Industrial Energy
General Electric Company	Users Group
GPU Industrial Intervenors	PSI Industrial Group
Indiana Industrial Group	Smith Cogeneration
Industrial Consumers for	Taconite Intervenors (Minnesota)
Fair Utility Rates - Indiana	West Penn Power Industrial Intervenors
Industrial Energy Consumers - Ohio	West Virginia Energy Users Group
Kentucky Industrial Utility Consumers	Westvaco Corporation
Kimberly-Clark	

**Regulatory Commissions and
Government Agencies**

Georgia Public Service Commission Staff
Kentucky Attorney General's Office, Division of Consumer Protection
Louisiana Public Service Commission Staff
Maine Office of Public Advocate
New York State Energy Office
Office of Public Utility Counsel (Texas)

RESUME OF LANE KOLLEN, VICE PRESIDENT

Utilities

Allegheny Power System
Atlantic City Electric Company
Carolina Power & Light Company
Cleveland Electric Illuminating Company
Delmarva Power & Light Company
Duquesne Light Company
General Public Utilities
Georgia Power Company
Middle South Services
Nevada Power Company
Niagara Mohawk Power Corporation

Otter Tail Power Company
Pacific Gas & Electric Company
Public Service Electric & Gas
Public Service of Oklahoma
Rochester Gas and Electric
Savannah Electric & Power Company
Seminole Electric Cooperative
Southern California Edison
Talquin Electric Cooperative
Tampa Electric
Texas Utilities
Toledo Edison Company

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdic.	Party	Utility	Subject
10/86	U-17282 Interim	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Cash revenue requirements financial solvency.
11/86	U-17282 Interim Rebuttal	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Cash revenue requirements financial solvency.
12/86	9613	KY	Attorney General Div. of Consumer Protection	Big Rivers Electric Corp	Revenue requirements accounting adjustments financial workout plan.
1/87	U-17282 Interim	LA 19th Judicial District Ct	Louisiana Public Service Commission Staff	Gulf States Utilities	Cash revenue requirements, financial solvency.
3/87	General Order 236	WV	West Virginia Energy Users' Group	Monongahela Power Co.	Tax Reform Act of 1986.
4/87	U-17282 Prudence	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Prudence of River Bend 1, economic analyses, cancellation studies.
4/87	M-100 Sub 113	NC	North Carolina Industrial Energy Consumers	Duke Power Co.	Tax Reform Act of 1986
5/87	86-524-E-	WV	West Virginia Energy Users' Group	Monongahela Power Co.	Revenue requirements Tax Reform Act of 1986.
5/87	U-17282 Case In Chief	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Revenue requirements, River Bend 1 phase-in plan, financial solvency.
7/87	U-17282 Case In Chief Surrebuttal	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Revenue requirements River Bend 1 phase-in plan, financial solvency.
7/87	U-17282 Prudence Surrebuttal	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Prudence of River Bend 1, economic analyses, cancellation studies.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdct.	Party	Utility	Subject
7/87	86-524 E-SC Rebuttal	WV	West Virginia Energy Users' Group	Monongahela Power Co.	Revenue requirements, Tax Reform Act of 1986.
8/87	9885	KY	Attorney General Div. of Consumer Protection	Big Rivers Electric Corp.	Financial workout plan
8/87	E-015/GR- 87-223	MN	Taconite Intervenors	Minnesota Power & Light Co.	Revenue requirements, O&M expense, Tax Reform Act of 1986.
10/87	870220-EI	FL	Occidental Chemical Corp.	Florida Power Corp.	Revenue requirements, O&M expense, Tax Reform Act of 1986.
11/87	87-07-01	CT	Connecticut Industrial Energy Consumers	Connecticut Light & Power Co.	Tax Reform Act of 1986.
1/88	U-17282	LA 19th Judicial District Ct.	Louisiana Public Service Commission Staff	Gulf States Utilities	Revenue requirements, River Bend 1 phase-in plan, rate of return.
2/88	9934	KY	Kentucky Industrial Utility Customers	Louisville Gas & Electric Co.	Economics of Trimble County completion
2/88	10064	KY	Kentucky Industrial Utility Customers	Louisville Gas & Electric Co.	Revenue requirements, O&M expense, capital structure, excess deferred income taxes.
5/88	10217	KY	Alcan Aluminum National Southwire	Big Rivers Electric	Financial workout plan. Corp.
5/88	M-87017 -1C001	PA	GPU Industrial Intervenors	Metropolitan Edison Co.	Nonutility generator deferred cost recovery.
5/88	M-87017 -2C005	PA	GPU Industrial Intervenors	Pennsylvania Electric Co.	Nonutility generator deferred cost recovery.
6/88	U-17282	LA 19th Judicial District Ct.	Louisiana Public Service Commission Staff	Gulf States Utilities	Prudence of River Bend 1 economic analyses, cancellation studies, financial modeling.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdic.	Party	Utility	Subject
7/88	M-87017-1C001 Rebuttal	PA	GPU Industrial Intervenors	Metropolitan Edison Co.	Nonutility generator deferred cost recovery, SFAS No. 92
7/88	M-87017-2C005 Rebuttal	PA	GPU Industrial Intervenors	Pennsylvania Electric Co.	Nonutility generator deferred cost recovery, SFAS No. 92
9/88	88-05-25	CT	Connecticut Industrial Energy Consumers	Connecticut Light & Power Co.	Excess deferred taxes, O&M expenses.
9/88	10064 Rehearing	KY	Kentucky Industrial Utility Customers	Louisville Gas & Electric Co.	Premature retirements, interest expense.
10/88	88-170- EL-AIR	OH	Ohio Industrial Energy Consumers	Cleveland Electric Illuminating Co.	Revenue requirements, phase-in, excess deferred taxes, O&M expenses, financial considerations, working capital.
10/88	88-171- EL-AIR	OH	Ohio Industrial Energy Consumers	Toledo Edison Co.	Revenue requirements, phase-in, excess deferred taxes, O&M expenses, financial Considerations, working capital.
10/88	8800 355-EI	FL	Florida Industrial Power Users' Group	Florida Power & Light Co.	Tax Reform Act of 1986, tax expenses, O&M expenses, pension expense (SFAS No. 87).
10/88	3780-U	GA	Georgia Public Service Commission Staff	Atlanta Gas Light Co.	Pension expense (SFAS No. 87)
11/88	U-17282 Remand	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Rate base exclusion plan (SFAS No. 71)
12/88	U-17970	LA	Louisiana Public Service Commission Staff	AT&T Communications of South Central States	Pension expense (SFAS No. 87).
12/88	U-17949 Rebuttal	LA	Louisiana Public Service Commission Staff	South Central Bell	Compensated absences (SFAS No. 43), pension expense (SFAS No. 87), Part 32, income tax normalization.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdic.	Party	Utility	Subject
2/89	U-17282 Phase II	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Revenue requirements, phase-in of River Bend 1, recovery of canceled plant.
6/89	881602-EU 890326-EU	FL	Talquin Electric Cooperative	Talquin/City of Tallahassee	Economic analyses, incremental cost-of-service, average customer rates.
7/89	U-17970	LA	Louisiana Public Service Commission Staff	AT&T Communications of South Central States	Pension expense (SFAS No. 87), compensated absences (SFAS No. 43), Part 32.
8/89	8555	TX	Occidental Chemical Corp	Houston Lighting & Power Co.	Cancellation cost recovery, tax expense, revenue requirements.
8/89	3840-U	GA	Georgia Public Service Commission Staff	Georgia Power Co.	Promotional practices, advertising, economic development.
9/89	U-17282 Phase II Detailed	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Revenue requirements, detailed investigation.
10/89	8880	TX	Enron Gas Pipeline	Texas-New Mexico Power Co.	Deferred accounting treatment, sale/leaseback.
10/89	8928	TX	Enron Gas Pipeline	Texas-New Mexico Power Co.	Revenue requirements, imputed capital structure, cash working capital.
10/89	R-891364	PA	Philadelphia Area Industrial Energy Users Group	Philadelphia Electric Co.	Revenue requirements.
11/89 12/89	R-891364 Surrebuttal (2 Filings)	PA	Philadelphia Area Industrial Energy Users Group	Philadelphia Electric Co.	Revenue requirements, sale/leaseback.
1/90	U-17282 Phase II Detailed Rebuttal	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Revenue requirements detailed investigation.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdct.	Party	Utility	Subject
1/90	U-17282 Phase III	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Phase-in of River Bend 1, deregulated asset plan.
3/90	890319-EI	FL	Florida Industrial Power Users Group	Florida Power & Light Co.	O&M expenses, Tax Reform Act of 1986.
4/90	890319-EI Rebuttal	FL	Florida Industrial Power Users Group	Florida Power & Light Co.	O&M expenses, Tax Reform Act of 1986.
4/90	U-17282	LA 19 th Judicial District Ct	Louisiana Public Service Commission Staff	Gulf States Utilities	Fuel clause, gain on sale of utility assets.
9/90	90-158	KY	Kentucky Industrial Utility Customers	Louisville Gas & Electric Co.	Revenue requirements, post-test year additions, forecasted test year.
12/90	U-17282 Phase IV	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Revenue requirements.
3/91	29327, et. al.	NY	Multiple Intervenors	Niagara Mohawk Power Corp.	Incentive regulation.
5/91	9945	TX	Office of Public Utility Counsel of Texas	El Paso Electric Co.	Financial modeling, economic analyses, prudence of Palo Verde 3.
9/91	P-910511 P-910512	PA	Allegheny Ludlum Corp., Armco Advanced Materials Co., The West Penn Power Industrial Users' Group	West Penn Power Co.	Recovery of CAAA costs, least cost financing.
9/91	91-231 -E-NC	WV	West Virginia Energy Users Group	Monongahela Power Co.	Recovery of CAAA costs, least cost financing.
11/91	U-17282	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Asset impairment, deregulated asset plan, revenue require- ments.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdic.	Party	Utility	Subject
12/91	91-410-EL-AIR	OH	Air Products and Chemicals, Inc., Armco Steel Co., General Electric Co., Industrial Energy Consumers	Cincinnati Gas & Electric Co.	Revenue requirements, phase-in plan.
12/91	10200	TX	Office of Public Utility Counsel of Texas	Texas-New Mexico Power Co.	Financial integrity, strategic planning, declined business affiliations.
5/92	910890-EI	FL	Occidental Chemical Corp.	Florida Power Corp.	Revenue requirements, O&M expense, pension expense, OPEB expense, fossil dismantling, nuclear decommissioning.
8/92	R-00922314	PA	GPU Industrial Intervenors	Metropolitan Edison Co.	Incentive regulation, performance rewards, purchased power risk, OPEB expense.
9/92	92-043	KY	Kentucky Industrial Utility Consumers	Generic Proceeding	OPEB expense.
9/92	920324-EI	FL	Florida Industrial Power Users' Group	Tampa Electric Co.	OPEB expense.
9/92	39348	IN	Indiana Industrial Group	Generic Proceeding	OPEB expense.
9/92	910840-PU	FL	Florida Industrial Power Users' Group	Generic Proceeding	OPEB expense.
9/92	39314	IN	Industrial Consumers for Fair Utility Rates	Indiana Michigan Power Co.	OPEB expense.
11/92	U-19904	LA	Louisiana Public Service Commission Staff	Gulf States Utilities/Entergy Corp.	Merger.
11/92	8649	MD	Westvaco Corp., Eastalco Aluminum Co.	Potomac Edison Co.	OPEB expense.
11/92	92-1715-AU-COI	OH	Ohio Manufacturers Association	Generic Proceeding	OPEB expense.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdic.	Party	Utility	Subject
12/92	R-00922378	PA	Armco Advanced Materials Co., The WPP Industrial Intervenors	West Penn Power Co	Incentive regulation, performance rewards, purchased power risk, OPEB expense.
12/92	U-19949	LA	Louisiana Public Service Commission Staff	South Central Bell	Affiliate transactions, cost allocations, merger.
12/92	R-00922479	PA	Philadelphia Area Industrial Energy Users' Group	Philadelphia Electric Co.	OPEB expense.
1/93	8487	MD	Maryland Industrial Group	Baltimore Gas & Electric Co., Bethlehem Steel Corp.	OPEB expense, deferred fuel, CWIP in rate base
1/93	39498	IN	PSI Industrial Group	PSI Energy, Inc.	Refunds due to over-collection of taxes on Marble Hill cancellation.
3/93	92-11-11	CT	Connecticut Industrial Energy Consumers	Connecticut Light & Power Co.	OPEB expense.
3/93	U-19904 (Surrebuttal)	LA	Louisiana Public Service Commission Staff	Gulf States Utilities/Entergy	Merger Corp.
3/93	93-01 EL-EFC	OH	Ohio Industrial Energy Consumers	Ohio Power Co	Affiliate transactions, fuel
3/93	EC92- 21000 ER92-806-000	FERC	Louisiana Public Service Commission Staff	Gulf States Utilities/Entergy	Merger. Corp.
4/93	92-1464- EL-AIR	OH	Air Products Armco Steel Industrial Energy Consumers	Cincinnati Gas & Electric Co.	Revenue requirements, phase-in plan.
4/93	EC92- 21000 ER92-806-000 (Rebuttal)	FERC	Louisiana Public Service Commission Staff	Gulf States Utilities/Entergy	Merger. Corp.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdct.	Party	Utility	Subject
9/93	93-113	KY	Kentucky Industrial Utility Customers	Kentucky Utilities	Fuel clause and coal contract refund.
9/93	92-490, 92-490A, 90-360-C	KY	Kentucky Industrial Utility Customers and Kentucky Attorney General	Big Rivers Electric Corp.	Disallowances and restitution for excessive fuel costs, illegal and improper payments, recovery of mine closure costs.
10/93	U-17735	LA	Louisiana Public Service Commission Staff	Cajun Electric Power Cooperative	Revenue requirements, debt restructuring agreement, River Bend cost recovery.
1/94	U-20647	LA	Louisiana Public Service Commission Staff	Gulf States Utilities Co.	Audit and investigation into fuel clause costs.
4/94	U-20647 (Surrebuttal)	LA	Louisiana Public Service Commission Staff	Gulf States Utilities	Nuclear and fossil unit performance, fuel costs, fuel clause principles and guidelines.
5/94	U-20178	LA	Louisiana Public Service Commission Staff	Louisiana Power & Light Co.	Planning and quantification issues of least cost integrated resource plan.
9/94	U-19904 Initial Post-Merger Earnings Review	LA	Louisiana Public Service Commission Staff	Gulf States Utilities Co.	River Bend phase-in plan, deregulated asset plan, capital structure, other revenue requirement issues.
9/94	U-17735	LA	Louisiana Public Service Commission Staff	Cajun Electric Power Cooperative	G&T cooperative ratemaking policies, exclusion of River Bend, other revenue requirement issues.
10/94	3905-U	GA	Georgia Public Service Commission Staff	Southern Bell Telephone Co.	Incentive rate plan, earnings review.
10/94	5258-U	GA	Georgia Public Service Commission Staff	Southern Bell Telephone Co.	Alternative regulation, cost allocation.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdict.	Party	Utility	Subject
11/94	U-19904 Initial Post-Merger Earnings Review (Rebuttal)	LA	Louisiana Public Service Commission Staff	Gulf States Utilities Co	River Bend phase-in plan, deregulated asset plan, capital structure, other revenue requirement issues.
11/94	U-17735 (Rebuttal)	LA	Louisiana Public Service Commission Staff	Cajun Electric Power Cooperative	G&T cooperative ratemaking policy, exclusion of River Bend, other revenue requirement issues.
4/95	R-00943271	PA	PP&L Industrial Customer Alliance	Pennsylvania Power & Light Co.	Revenue requirements. Fossil dismantling, nuclear decommissioning.
6/95	3905-U	GA	Georgia Public Service Commission	Southern Bell Telephone Co.	Incentive regulation, affiliate transactions, revenue requirements, rate refund.
6/95	U-19904 (Direct)	LA	Louisiana Public Service Commission	Gulf States Utilities Co.	Gas, coal, nuclear fuel costs, contract prudence, base/fuel realignment.
10/95	95-02614	TN	Tennessee Office of the Attorney General Consumer Advocate	BellSouth Telecommunications, Inc.	Affiliate transactions.
10/95	U-21485 (Direct)	LA	Louisiana Public Service Commission	Gulf States Utilities Co.	Nuclear O&M, River Bend phase-in plan, base/fuel realignment, NOL and AltMin asset deferred taxes, other revenue requirement issues.
11/95	U-19904 (Surrebuttal)	LA	Louisiana Public Service Commission	Gulf States Utilities Co. Division	Gas, coal, nuclear fuel costs, contract prudence, base/fuel realignment.
11/95	U-21485 (Supplemental Direct)	LA	Louisiana Public Service Commission	Gulf States Utilities Co.	Nuclear O&M, River Bend phase-in plan, base/fuel realignment, NOL and AltMin asset deferred taxes, other revenue requirement issues.
12/95	U-21485 (Surrebuttal)				

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdic.	Party	Utility	Subject
1/96	95-299-EL-AIR 95-300-EL-AIR	OH	Industrial Energy Consumers	The Toledo Edison Co. The Cleveland Electric Illuminating Co.	Competition, asset writeoffs and revaluation, O&M expense, other revenue requirement issues.
2/96	PUC No. 14967	TX	Office of Public Utility Counsel	Central Power & Light	Nuclear decommissioning
5/96	95-485-LCS	NM	City of Las Cruces	El Paso Electric Co.	Stranded cost recovery, municipalization.
7/96	8725	MD	The Maryland Industrial Group and Redland Genstar, Inc.	Baltimore Gas & Electric Co., Potomac Electric Power Co. and Constellation Energy Corp.	Merger savings, tracking mechanism, earnings sharing plan, revenue requirement issues.
9/96 11/96	U-22092 U-22092 (Surrebuttal)	LA	Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.	River Bend phase-in plan, base/fuel realignment, NOL and AltMin asset deferred taxes, other revenue requirement issues, allocation of regulated/nonregulated costs.
10/96	96-327	KY	Kentucky Industrial Utility Customers, Inc.	Big Rivers Electric Corp.	Environmental surcharge recoverable costs.
2/97	R-00973877	PA	Philadelphia Area Industrial Energy Users Group	PECO Energy Co.	Stranded cost recovery, regulatory assets and liabilities, intangible transition charge, revenue requirements.
3/97	96-489	KY	Kentucky Industrial Utility Customers, Inc.	Kentucky Power Co.	Environmental surcharge recoverable costs, system agreements, allowance inventory, jurisdictional allocation.
6/97	TO-97-397	MO	MCI Telecommunications Corp., Inc., MCImetro Access Transmission Services, Inc.	Southwestern Bell Telephone Co.	Price cap regulation, revenue requirements, rate of return.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdct.	Party	Utility	Subject
6/97	R-00973953	PA	Philadelphia Area Industrial Energy Users Group	PECO Energy Co.	Restructuring, deregulation, stranded costs, regulatory assets, liabilities, nuclear and fossil decommissioning.
7/97	R-00973954	PA	PP&L Industrial Customer Alliance	Pennsylvania Power & Light Co.	Restructuring, deregulation, stranded costs, regulatory assets, liabilities, nuclear and fossil decommissioning.
7/97	U-22092	LA	Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.	Depreciation rates and methodologies, River Bend phase-in plan.
8/97	97-300	KY	Kentucky Industrial Utility Customers, Inc.	Louisville Gas & Electric Co. and Kentucky Utilities Co.	Merger policy, cost savings, surcredit sharing mechanism, revenue requirements, rate of return.
8/97	R-00973954 (Surrebuttal)	PA	PP&L Industrial Customer Alliance	Pennsylvania Power & Light Co.	Restructuring, deregulation, stranded costs, regulatory assets, liabilities, nuclear and fossil decommissioning.
10/97	97-204	KY	Alcan Aluminum Corp. Southwire Co.	Big Rivers Electric Corp.	Restructuring, revenue requirements, reasonableness
10/97	R-974008	PA	Metropolitan Edison Industrial Users Group	Metropolitan Edison Co.	Restructuring, deregulation, stranded costs, regulatory assets, liabilities, nuclear and fossil decommissioning, revenue requirements
10/97	R-974009	PA	Penelec Industrial Customer Alliance	Pennsylvania Electric Co.	Restructuring, deregulation, stranded costs, regulatory assets, liabilities, nuclear and fossil decommissioning, revenue requirements
11/97	97-204 (Rebuttal)	KY	Alcan Aluminum Corp. Southwire Co.	Big Rivers Electric Corp.	Restructuring, revenue requirements, reasonableness of rates, cost allocation

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdic.	Party	Utility	Subject
11/97	U-22491	LA	Louisiana Public Service Commission	Entergy Gulf States, Inc.	Allocation of regulated and nonregulated costs, other revenue requirement issues.
11/97	R-00973953 (Surrebuttal)	PA	Philadelphia Area Industrial Energy Users Group	PECO Energy Co.	Restructuring, deregulation, stranded costs, regulatory assets, liabilities, nuclear and fossil decommissioning.
11/97	R-973981	PA	West Penn Power Industrial Intervenors	West Penn Power Co.	Restructuring, deregulation, stranded costs, regulatory assets, liabilities, fossil decommissioning, revenue requirements, securitization.
11/97	R-974104	PA	Duquesne Industrial Intervenors	Duquesne Light Co	Restructuring, deregulation, stranded costs, regulatory assets, liabilities, nuclear and fossil decommissioning, revenue requirements, securitization.
12/97	R-973981 (Surrebuttal)	PA	West Penn Power Industrial Intervenors	West Penn Power Co.	Restructuring, deregulation, stranded costs, regulatory assets, liabilities, fossil decommissioning, revenue requirements.
12/97	R-974104 (Surrebuttal)	PA	Duquesne Industrial Intervenors	Duquesne Light Co	Restructuring, deregulation, stranded costs, regulatory assets, liabilities, nuclear and fossil decommissioning, revenue requirements, securitization.
1/98	U-22491 (Surrebuttal)	LA	Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.	Allocation of regulated and nonregulated costs, other revenue requirement issues.
2/98	8774	MD	Westvaco	Potomac Edison Co.	Merger of Duquesne, AE, customer safeguards, savings sharing.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdict.	Party	Utility	Subject
3/98	U-22092 (Allocated Stranded Cost Issues)	LA	Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.	Restructuring, stranded costs, regulatory assets, securitization, regulatory mitigation.
3/98	8390-U	GA	Georgia Natural Gas Group, Georgia Textile Manufacturers Assoc.	Atlanta Gas Light Co.	Restructuring, unbundling, stranded costs, incentive regulation, revenue requirements.
3/98	U-22092 (Allocated Stranded Cost Issues) (Surrebuttal)	LA	Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.	Restructuring, stranded costs, regulatory assets, securitization, regulatory mitigation.
10/98	97-596	ME	Maine Office of the Public Advocate	Bangor Hydro- Electric Co.	Restructuring, unbundling, stranded costs, T&D revenue requirements
10/98	9355-U	GA	Georgia Public Service Commission Adversary Staff	Georgia Power Co.	Affiliate transactions.
10/98	U-17735	LA	Louisiana Public Service Commission Staff	Cajun Electric Power Cooperative	G&T cooperative ratemaking policy, other revenue requirement issues.
11/98	U-23327	LA	Louisiana Public Service Commission Staff	SWEPCO, CSW and AEP	Merger policy, savings sharing mechanism, affiliate transaction conditions.
12/98	U-23358 (Direct)	LA	Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.	Allocation of regulated and nonregulated costs, tax issues, and other revenue requirement issues.
12/98	98-577	ME	Maine Office of Public Advocate	Maine Public Service Co.	Restructuring, unbundling, stranded cost, T&D revenue requirements.
1/99	98-10-07	CT	Connecticut Industrial Energy Consumers	United Illuminating Co.	Stranded costs, investment tax credits, accumulated deferred income taxes, excess deferred income taxes.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdct.	Party	Utility	Subject
3/99	U-23358 (Surrebuttal)	LA	Louisiana Public Service Commission Staff	Entergy Gulf States, Inc	Allocation of regulated and nonregulated costs, tax issues, and other revenue requirement issues.
3/99	98-474	KY	Kentucky Industrial Utility Customers	Louisville Gas and Electric Co.	Revenue requirements, alternative forms of regulation.
3/99	98-426	KY	Kentucky Industrial Utility Customers	Kentucky Utilities Co.	Revenue requirements, alternative forms of regulation.
3/99	99-082	KY	Kentucky Industrial Utility Customers	Louisville Gas and Electric Co.	Revenue requirements.
3/99	99-083	KY	Kentucky Industrial Utility Customers	Kentucky Utilities Co.	Revenue requirements.
4/99	U-23358 (Supplemental Surrebuttal)	LA	Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.	Allocation of regulated and nonregulated costs, tax issues, and other revenue requirement issues.
4/99	99-03-04	CT	Connecticut Industrial Energy Consumers mechanisms	United Illuminating Co.	Regulatory assets and liabilities, stranded costs, recovery
4/99	99-02-05	CT	Connecticut Industrial Utility Customers mechanisms	Connecticut Light and Power Co.	Regulatory assets and liabilities stranded costs, recovery
5/99	98-426 99-082 (Additional Direct)	KY	Kentucky Industrial Utility Customers	Louisville Gas and Electric Co.	Revenue requirements.
5/99	98-474 99-083 (Additional Direct)	KY	Kentucky Industrial Utility Customers	Kentucky Utilities Co.	Revenue requirements.
5/99	98-426 98-474 (Response to Amended Applications)	KY	Kentucky Industrial Utility Customers Kentucky Utilities Co.	Louisville Gas and Electric Co. and Kentucky Utilities Co.	Alternative regulation.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdict.	Party	Utility	Subject
6/99	97-596	ME	Maine Office of Public Advocate	Bangor Hydro- Electric Co.	Request for accounting order regarding electric industry restructuring costs.
6/99	U-23358	LA	Louisiana Public Public Service Comm. Staff	Entergy Gulf States, Inc.	Affiliate transactions, cost allocations.
7/99	99-03-35	CT	Connecticut Industrial Energy Consumers	United Illuminating Co.	Stranded costs, regulatory assets, tax effects of asset divestiture.
7/99	U-23327	LA	Louisiana Public Service Commission Staff	Southwestern Electric Power Co., Central and South West Corp, and American Electric Power Co.	Merger Settlement Stipulation.
7/99	97-596 (Surrebuttal)	ME	Maine Office of Public Advocate	Bangor Hydro- Electric Co.	Restructuring, unbundling, stranded cost, T&D revenue requirements.
7/99	98-0452- E-GI	WVa	West Virginia Energy Users Group	Monongahela Power, Potomac Edison, Appalachian Power, Wheeling Power	Regulatory assets and liabilities.
8/99	98-577 (Surrebuttal)	ME	Maine Office of Public Advocate	Maine Public Service Co.	Restructuring, unbundling, stranded costs, T&D revenue requirements.
8/99	98-426 99-082 (Rebuttal)	KY	Kentucky Industrial Utility Customers	Kentucky Utilities Co.	Revenue requirements.
8/99	98-474 98-083 (Rebuttal)	KY	Kentucky Industrial Utility Customers Kentucky Utilities Co.	Louisville Gas and Electric Co. and	Alternative forms of regulation.
8/99	98-0452- E-GI (Rebuttal)	WVa	West Virginia Energy Users Group	Monongahela Power, Potomac Edison, Appalachian Power, Wheeling Power	Regulatory assets and liabilities.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdict.	Party	Utility	Subject
10/99	U-24182 (Direct)	LA	Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.	Allocation of regulated and nonregulated costs, affiliate transactions, tax issues, and other revenue requirement issues.
11/99	21527	TX	Dallas-Ft. Worth Hospital Council and Coalition of Independent Colleges and Universities	TXU Electric	Restructuring, stranded costs, taxes, securitization.
11/99	U-23358 Surrebuttal Affiliate Transactions Review	LA	Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.	Service company affiliate transaction costs
04/00	99-1212-EL-ETPOH 99-1213-EL-ATA 99-1214-EL-AAM		Greater Cleveland Growth Association	First Energy (Cleveland Electric Illuminating, Toledo Edison)	Historical review, stranded costs, regulatory assets, liabilities.
01/00	U-24182 (Surrebuttal)	LA	Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.	Allocation of regulated and nonregulated costs, affiliate transactions, tax issues, and other revenue requirement issues.
05/00	2000-107	KY	Kentucky Industrial Utility Customers	Kentucky Power Co.	ECR surcharge roll-in to base rates.
05/00	U-24182 (Supplemental Direct)	LA	Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.	Affiliate expense proforma adjustments.
05/00	A-110550F0147 PA		Philadelphia Area Industrial Energy Users Group	PECO Energy	Merger between PECO and Unicom.
07/00	22344	TX	The Dallas-Fort Worth Hospital Council and The Coalition of Independent Colleges and Universities	Statewide Generic Proceeding	Escalation of O&M expenses for unbundled T&D revenue requirements in projected test year.
08/00	U-24064	LA	Louisiana Public Service Commission Staff	CLECO	Affiliate transaction pricing ratemaking principles, subsidization of nonregulated affiliates, ratemaking adjustments.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdct.	Party	Utility	Subject
11/00	PUC 22350 SOAH 473-00-1015	TX	The Dallas-Ft. Worth Hospital Council and The Coalition of Independent Colleges And Universities	TXU Electric Co.	Restructuring, T&D revenue requirements, mitigation, regulatory assets and liabilities
10/00	R-00974104 (Affidavit)	PA	Duquesne Industrial Intervenors	Duquesne Light Co.	Final accounting for stranded costs, including treatment of auction proceeds, taxes, capital costs, switchback costs, and excess pension funding.
11/00	P-00001837 R-00974008 P-00001838 R-00974009		Metropolitan Edison Industrial Users Group Penelec Industrial Customer Alliance	Metropolitan Edison Co. Pennsylvania Electric Co.	Final accounting for stranded costs, including treatment of auction proceeds, taxes, regulatory assets and liabilities, transaction costs
12/00	U-21453, U-20925, U-22092 (Subdocket C) (Surrebuttal)	LA	Louisiana Public Service Commission Staff	SWEPCO	Stranded costs, regulatory assets
01/01	U-24993 (Direct)		Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.	Allocation of regulated and nonregulated costs, tax issues, and other revenue requirement issues.
01/01	U-21453, U-20925 and U-22092 (Subdocket B) (Surrebuttal)		Louisiana Public Service Commission Staff	Entergy Gulf States, Inc.,	Industry restructuring, business separation plan, organization structure, hold harmless conditions, financing
01/01	Case No. 2000-386	KY	Kentucky Industrial Utility Customers, Inc.	Louisville Gas & Electric Co.	Recovery of environmental costs, surcharge mechanism.
01/01	Case No. 2000-439	KY	Kentucky Industrial Utility Customers, Inc.	Kentucky Utilities Co.	Recovery of environmental costs, surcharge mechanism.
02/01	A-110300F0095 A-110400F0040	PA	Met-Ed Industrial Users Group Penelec Industrial Customer Alliance	GPU, Inc. FirstEnergy	Merger, savings, reliability.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdct.	Party	Utility	Subject
03/01	P-00001860 P-00001861	PA	Met-Ed Industrial Users Group Penelec Industrial Customer Alliance	Metropolitan Edison Co. and Pennsylvania Electric Co.	Recovery of costs due to provider of last resort obligation.
04 /01	U-21453, U-20925, U-22092 (Subdocket B) Settlement Term Sheet	LA	Louisiana Public Public Service Comm. Staff	Entergy Gulf States, Inc.	Business separation plan: settlement agreement on overall plan structure.
04 /01	U-21453, U-20925, U-22092 (Subdocket B) Contested Issues	LA	Louisiana Public Public Service Comm. Staff	Entergy Gulf States, Inc.	Business separation plan: agreements, hold harmless conditions, separations methodology.
05 /01	U-21453, U-20925, U-22092 (Subdocket B) Contested Issues Transmission and Distribution (Rebuttal)	LA	Louisiana Public Public Service Comm. Staff	Entergy Gulf States, Inc.	Business separation plan: agreements, hold harmless conditions, Separations methodology.
07/01	U-21453, U-20925, U-22092 (Subdocket B) Transmission and Distribution Term Sheet	LA	Louisiana Public Public Service Comm Staff	Entergy Gulf States, Inc	Business separation plan: settlement agreement on T&D issues, agreements necessary to implement T&D separations, hold harmless conditions, separations methodology.
10/01	14000-U	GA	Georgia Public Service Commission Adversary Staff	Georgia Power Co	Review requirements, Rate Plan, fuel clause recovery.
11/01 (Direct)	14311-U	GA	Georgia Public Service Commission Adversary Staff	Atlanta Gas Light Co.	Revenue requirements, revenue forecast, O&M expense, depreciation, plant additions, cash working capital.
11/01 (Direct)	U-25687	LA	Louisiana Public Service Commission	Entergy Gulf States, Inc.	Revenue requirements, capital structure, allocation of regulated and nonregulated costs, River Bend uprate.

**Expert Testimony Appearances
of
Lane Kollen
As of December 2002**

Date	Case	Jurisdic.	Party	Utility	Subject
02/02	25230	TX	Dallas Ft.-Worth Hospital Council & the Coalition of Independent Colleges & Universities	TXU Electric	Stipulation. Regulatory assets, securitization financing.
02/02 (Surrebuttal)	U-25687	LA	Louisiana Public Service Commission	Entergy Gulf States, Inc.	Revenue requirements, corporate franchise tax, conversion to LLC, River Bend uprate.
03/02 (Rebuttal)	14311-U	GA	Georgia Public Service Commission Adversary Staff	Atlanta Gas Light Co.	Revenue requirements, earnings sharing plan, service quality standards.
03/02	001148-EI	FL	South Florida Hospital and Healthcare Assoc.	Florida Power & Light Co.	Revenue requirements. Nuclear life extension, storm damage accruals and reserve, capital structure, O&M expense.
04/02 (Supplemental Surrebuttal)	U-25687	LA	Louisiana Public Service Commission	Entergy Gulf States, Inc.	Revenue requirements, corporate franchise tax, conversion to LLC, River Bend uprate.
04/02	U-21453, U-20925 and U-22092 (Subdocket C)		Louisiana Public Service Commission Staff	SWEPSCO	Business separation plan, T&D Term Sheet, separations methodologies, hold harmless conditions.
08/02	EL01-88-000	FERC	Louisiana Public Service Commission Staff	Entergy Services, Inc and The Entergy Operating Companies	System Agreement, production cost equalization tariffs.
08/02	U-25888	LA	Louisiana Public Service Commission	Entergy Gulf States, Inc. and Entergy Louisiana, Inc	System Agreement, production cost disparities, prudence.
09/02	2002-00224 2002-00225	KY	Kentucky Industrial Utilities Customers, Inc.	Kentucky Utilities Co Louisville Gas & Electric Co.	Fuel clause recovery of line losses associated with off-system sales.

EXHIBIT ____ (LK-2)

Kentucky Power
d/b/a
American Electric Power

REQUEST

Refer to the Wagner Direct Testimony, Exhibit EKW-3.

- a. Describe the sources of Kentucky Power's short-term financing.
- b. Does Kentucky Power borrow funds from any AEP money pool arrangements? If yes, describe Kentucky Power's participation in the AEP money pool.
- c. Does Kentucky Power utilize accounts receivable financing? If yes, describe how this financing is structured.
- d. Provide Kentucky Power's weighted cost of capital calculations as of October 31, 2002. If applicable, show any financing utilizing money pool borrowings and accounts receivable financing separately.
- e. Provide by January 30, 2003 Kentucky Power's weighted cost of capital calculations as of December 31, 2002. If applicable, show any financing utilizing money pool borrowings and accounts receivable financing separately.

RESPONSE

- a. Kentucky Power obtains short term financing by borrowing funds from the AEP Money Pool.
- b. The AEP Money Pool is a mechanism structured to meet the short-term cash requirements of its participants. The operation of the AEP Money Pool is designed to match on a daily basis the available cash and borrowing requirements of participants, thus minimizing the need to borrow from external sources.

The cash position of each Money Pool participant is determined on a daily basis. Available funds from all participants are “pooled” in determining net external borrowing needs. Any excess funds are loaned to other companies in the pool or invested in short-term cash instruments on behalf of the AEP Money Pool participants.

If the cash needs of the participants exceed the available cash, American Electric Power Company, Inc. raises funds through short-term borrowing. The borrowing is primarily commercial paper.

A daily interest rate is calculated and applied to all participant borrowings and investments in the Money Pool. The interest rate reflects the daily weighted-average cost of borrowing.

Money Pool participants are also charged a pro rata cost of certain expenses associated with the borrowing program, including fees associated with bank lines of credit, rating agencies, and the issuing and paying agent.

c. Yes, Kentucky Power utilizes accounts receivable financing.

AEP Credit, Inc., a wholly owned subsidiary of AEP, which does not participate in the AEP Money Pool, provides low cost financing for AEP Utility subsidiaries, including Kentucky Power, through factoring receivables, which arise primarily from the sale and delivery of electricity in the ordinary course of business. AEP Credit was formed for the purpose of purchasing accounts receivable (receivables) at a discount (factoring) and financing these purchases at an SEC approved debt to equity ratio.

Each company selling (factoring) its receivables to AEP Credit has executed a Purchase Agreement and an Agency Agreement, which outlines how the basic transactions take place. Either party upon 30 days written notice to the other party may terminate the Purchase Agreement and Agency Agreement.

AEP Credit is authorized by the SEC to purchase, without recourse, certain receivables arising from the sale or delivery of electricity, gas and other related services in the Seller's ordinary course of business. The price AEP Credit pays for the receivables is the dollar amount of the receivables less a discount (purchase price). The determination of the discount is based upon AEP Credit's cost of financing, the Seller's collection experience and an agency fee.

The Seller has agreed through the Agency Agreement to service, administer and collect such receivables on behalf of AEP Credit.

AEP Credit has entered into a sale of receivables agreement with a group of banks and commercial paper conduits. Under the sale of receivables agreement, AEP Credit sells an interest in the receivables it has acquired from the Sellers to the commercial paper conduits and banks and receives cash.

d. The amount shown as short-term debt is the amount of financing which utilized the money pool. Accounts receivable financing amount is not included in the Company's capitalization. Attached is the Company's weighted cost of capital calculation as of October 31, 2002.

e. The Company's response to the money pool borrowings and the accounts receivable financing portion of this question is the same as the Company's response to part "d" of this question. The requested information should be available during the week of January 27, 2003 and will be provided at that time.

WITNESS: Errol K Wagner

AEP / Kentucky
Environmental Surcharge
Weighted Cost of Capital Calculations

Exhibit EKW - 3
Rev 11/20/02

Ln No	Decription (2)	Cap. Bal. 10/31/2002 (3)	Capital Structure % (4)	Annual Interest Cost (5)	Cost of Capital Rate (6)	Gross Revenue Conversion Factor (7)	Weighted Average Cost of Capital (8)
1	L/T Debt	\$385,945,461	51.53%	\$22,168,505	5.74%		2.96%
2	S/T Debt	\$105,311,518	14.06%	\$2,349,500	2.23%		0.31%
3	C Equity	<u>\$257,653,371</u>	<u>34.40%</u>		12.75% a/	<u>1.6801</u> b/	<u>7.37%</u>
4	Total	<u>\$748,910,350</u>	<u>100.00%</u>				<u>10.64%</u>

Source:

a/ Cost of Equity per Company Witness Moul

b/ Gross Revenue Conversion Factor Calculations

1	Operating Revenue	100.00%
2	Uncollectible	<u>0.20%</u>
3	Income Before State Tax	99.80%
4	Less: State Income Tax	
5	(Ln 3 x .0825)	<u>8.23%</u>
6	Income Before Fed Inc Tax	91.57%
7	Less: Federal Inc Tax	
8	(Ln 6 x .35)	<u>32.05%</u>
9	Operating Income Percentage	<u>59.52%</u>
10	Gross Revenue Conversion	
11	Factor (100%/ Ln 9)	1.6801

EXHIBIT ____ (LK-3)

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY POWER COMPANY)
d/b/a AMERICAN ELECTRIC POWER TO ASSESS)
A SURCHARGE UNDER KRS 278.183 TO)
RECOVER COSTS OF COMPLIANCE WITH THE) CASE NO. 96-489
CLEAN AIR ACT AND THOSE ENVIRONMENTAL)
REQUIREMENTS WHICH APPLY TO COAL)
COMBUSTION WASTE AND BY-PRODUCTS)

O R D E R

On November 27, 1996, Kentucky Power Company, d/b/a American Electric Power ("Kentucky Power") filed an application, pursuant to KRS 278.183, for approval of its environmental compliance plan and rate surcharge to recover its costs of environmental compliance. Kentucky Power proposed to make the surcharge effective on December 31, 1996, and estimated that it would recover approximately \$3,000,000 to \$5,000,000 over the two year period beginning December 31, 1996. Pursuant to KRS 278.183(2), the Commission must: (1) consider and approve a compliance plan and rate surcharge if the Commission finds the plan and rate surcharge reasonable and cost-effective for compliance with the applicable environmental requirements; (2) establish a reasonable return on compliance-related capital expenditures; and (3) approve the application of the surcharge. The Commission has six months from the date the application is filed to conduct the necessary proceedings. Consequently, by Order dated December 19, 1996, the Commission suspended Kentucky Power's proposed tariff through May 26, 1997.

requirements. The formulas used to determine these amounts are shown in Appendix A. After $E(m)$ is calculated, a portion of this amount will be allocated to Kentucky retail customers. The Environmental Surcharge Factor charged to Kentucky retail customers will be calculated by dividing the Monthly Kentucky Retail $E(m)$ by the Monthly Kentucky Retail Revenue for the Current Expense Month, $R(m)$.

SURCHARGE ALLOCATION

As noted previously, Kentucky Power proposed to allocate its surcharge only to its Kentucky retail and FERC municipal customers. Kentucky Power contended that any attempt to allocate a portion of its compliance investments to non-Kentucky Power retail sales reflected a fundamental misunderstanding of the nature of its investment, and a clear misreading of KRS 278.183.⁵⁷ Kentucky Power claimed that the compliance costs incurred by it at Big Sandy and Rockport were incurred solely for the benefit of Kentucky Power's full-requirement customers. Kentucky Power argued that its capacity was constructed, maintained, and reserved for these customers.⁵⁸ Kentucky Power stated that its customers were receiving the full benefit of its plant facilities, and accordingly should bear the capital costs associated with environmental equipment required to be placed on those facilities.

Concerning off-system sales, Kentucky Power contended that these were merely opportunity sales which can fluctuate quite dramatically. Kentucky Power noted that because of its system sales tracker, one half of any profit or loss from off-system sales

⁵⁷ Kentucky Power Brief at 50.

⁵⁸ Id.

above or below the level in base rates goes back to ratepayers. Therefore, Kentucky Power argued it was not in the ratepayers' best interest to increase the cost of these off-system sales, thereby reducing their profitability, and perhaps preventing some sales from being made.⁵⁹

The AG and KIUC argued that Kentucky Power should allocate the surcharge over all sales revenues. The AG stated that such an allocation was consistent with the Commission's rulings in the three previous surcharge cases.⁶⁰ KIUC argued that costs should be allocated to the cost causer and the Commission has repeatedly held there is some relationship between energy consumed and the pollution caused by generating the energy.⁶¹

The Commission finds that the monthly surcharge should be allocated over all sales revenues. While disagreeing with the concept of allocating costs to all sales, Kentucky Power did agree that if the Commission rejected its proposed methodology, a percentage of revenues methodology would be more appropriate than a per Kwh basis.⁶² The arguments put forth by Kentucky Power have all been made in the previous surcharge cases and the Commission has rejected each one. Kentucky Power's generating facilities are currently used to make off-system sales and the cost of environmental improvements should be allocated to both retail and off-system sales.

⁵⁹ Id. at 51.

⁶⁰ AG Brief at 14.

⁶¹ KIUC Brief at 30.

⁶² T.E., Vol. II, April 3, 1997, at 102.

Kentucky Power has failed to demonstrate that the allocation of the surcharge to off-system sales would lower the margins on those sales to the point they would be uneconomical. To the extent that Kentucky Power is able to sell power off-system, proper cost allocation requires that the costs attributable to those sales, including environmental costs, be assigned to such sales, rather than being charged to retail sales. Kentucky Power has submitted no analysis to demonstrate the impact on the system sales tracker of allocating surcharge costs to all sales. Kentucky Power presented no basis to justify a revenue allocation that differs from the allocations utilized by the other utilities authorized an environmental surcharge. Thus, the Commission will not utilize the Jurisdictional Allocation Factor proposed by Kentucky Power. The allocation to Kentucky retail customers will be a calculation dividing the monthly Kentucky retail revenues by the monthly Total Company revenues. Total Company revenues will include revenues from sales to other AEP System members and sales to parties other than AEP System members.

RATE OF RETURN

Kentucky Power proposed that it be allowed a rate of return that included debt and equity, and submitted testimony in support of its proposal. It further proposed that the debt portion be recalculated monthly to more closely reflect the cost actually incurred, while the equity portion would be reviewed for reasonableness at the 2-year reviews.⁶³ Kentucky Power proposed a rate of return on common equity of 12 percent.⁶⁴

⁶³ Response to the Commission's February 7, 1997 Order, Item 13.

⁶⁴ Barber Direct Testimony at 26.

EXHIBIT ____ (LK-4)

COMMONWEALTH OF KENTUCKY
FRANKLIN CIRCUIT COURT
CONSOLIDATED CIVIL ACTION
NOS. 97-CI-1144, 97-CI-01138, 97-CI-01319
DIVISION I

ENTERED

APR 30 1998

FRANKLIN CIRCUIT COURT
JANICE MARSHALL, CLERK

COMMONWEALTH OF KENTUCKY,
ex rel. A.B. CHANDLER, III,
ATTORNEY GENERAL

PLAINTIFF

v.

OPINION AND ORDER

KENTUCKY PUBLIC SERVICE COMMISSION, ET AL

DEFENDANTS

This is a consolidated action arising from orders dated May 27, 1997, July 8, 1997, and August 18, 1997, of the Kentucky Public Service Commission (hereinafter "the PSC" and "the Commission") in Case No. 96-489 which considered an application by Kentucky Power Company d/b/a American Electric Power (hereinafter "Kentucky Power" or the "Company") for an environmental surcharge pursuant to KRS 278.183.

Kentucky Power has appealed four determinations made by the PSC:

- (a) the PSC's denial of substantial portions of the Company's application to recover costs pursuant to an environmental surcharge authorized by KRS 278.183;
- (b) the PSC's requirement that the costs of new equipment required by the Clean Air Act Amendments ("CAAA's") be offset by the cost of equipment rendered obsolete by the

488, 490 (1991); "(r)adical departure from (past) administrative interpretations consistently followed cannot be made except for the most cogent reasons."

South Central Bell Tel. v. Public Service Comm., Ky. App., 702 S.W.2d 447, 451

(1985); "It is well established that the practical construction of a statute by administrative officers over a long period of time is entitled to controlling weight."

Barnes v. Department of Revenue, Ky. App., 575 S.W.2d 169, 171 (1978).

III. The Allocation Of Environmental Costs To The Kentucky Jurisdiction Was Reasonable And Based Upon Substantial Evidence.

An important factual issue in every surcharge proceeding is the amount of environmental costs allocated to Kentucky jurisdictional ratepayers and the amount allocated to non-jurisdictional wholesale sales. Kentucky Power recommended that 98.6% of surcharge costs be allocated to Kentucky and that 1.4% be allocated to non-jurisdictional sales. (Wagner direct testimony at 8). Mr. Wagner calculated his jurisdictional allocation factors based upon a peak demand study. KIUC recommended that environmental costs should be allocated on the basis of total revenue, not peak demand. This was the same allocation method used by the Commission in the three prior surcharge cases. (Kollen direct testimony at 21).

The Commission continued to follow the total revenue allocation method. (May 27, 1997 Order at 31-32). The Commission concluded that because

Kentucky Power's generating facilities are currently used to make off-system sales, the cost of environmental improvements should be allocated to both retail and off-system sales. The Commission determined that allocating only 1.4% of environmental costs to off-system sales as recommended by Kentucky Power was unreasonable since over 36% of Kentucky Power's energy production was sold off-system in 1996. The total revenue allocation approach adopted by the Commission allocates approximately 17% of environmental costs to off-system sales.

On appeal, Kentucky Power argued that the allocation of environmental costs attributable to off-system sales is contrary to KRS 278.183 and established regulatory principles. Kentucky Power argued that since its generating facilities are dedicated to serve retail customers, the method of cost allocation should be peak demand and the total revenue method chosen by the Commission is improper. Kentucky Power also argued that the allocation of environmental costs to sales to affiliated AEP companies unlawfully traps those costs in violation of the preemption doctrine. This Court can find no legal error in the Commission's ratemaking allocation of environmental costs.

KIUC witness Kollen testified in opposition to the use of a demand allocation methodology. The reasons for his opposition were that: 1) a demand allocation has never received explicit Commission approval in any base rate or surcharge case; 2) a demand allocation is inconsistent with the physical operation

of Kentucky Power's system since approximately 36 percent of sales are to non-retail customers; and 3) sales revenues, not demand, have been used in all prior environmental surcharge cases to allocate costs. (T.E. , Vol. 17,p. 23-24).

Because Kentucky Power's system is currently operated to supply wholesale sales for resale, a representative cost allocation must be made to these sales. 36.17% of Kentucky Power's energy sales were to wholesale (sales for resale) customers in 1996. (Kollen direct testimony at 21; KIUC Cross Exam Ex.6). Those sales represented 17.83% of its total revenues in 1996. (Id.) These statistics point out the inherent unreasonableness of allocating only 1.4% of environmental costs to off-system sales as recommended by Kentucky Power. The Commission's total revenue allocation method (17%) is a fair compromise between a demand allocation (1.4%) and an energy allocation (36%).

Despite the huge blocks of power sold off-system, Kentucky Power maintains that Kentucky ratepayers should pay for 98.6% of all its new environmental costs. The Commission disagreed and ruled that costs should be allocated to the cost causer. The Commission held that there is some relationship between the energy consumed and the pollution caused by generating that energy. That decision is reasonable and should be affirmed.

Kentucky Power also argued that allocating 98.6% of environmental costs to Kentucky ratepayers is required by the operation of the system sales clause included in base rates. The system sales clause resulted from a rate case

settlement and provides that if the profit from Kentucky Power's share of AEP off-system sales is greater than or less than the baseline amount of \$11.3 million, then the ratepayers and the utility will share the benefit or burden 50/50. (T.E., Vol. II at 138). Sometimes the system sales clause is negative, thus benefitting the utility and sometimes it is positive, thus benefitting the ratepayers. (Id.)

Kentucky Power's argument regarding the level of sales profits passed through its base rate sales tracker lacks merit. It was Kentucky Power that elected to file an application for an environmental surcharge under KRS 278.183, rather than file an application to adjust base rates under KRS 278.190. KRS 278.183 mandates surcharge recovery of qualifying environmental costs "[n]otwithstanding any other provision of this chapter. . . ." KRS 278.183(1). The Commission simply has no authority under a 278.183 proceeding to adjust either the off system sales profits in base rates or the system sales tracker as suggested by Kentucky Power. To the extent that Kentucky Power's profit margins on off system sales are lower because of environmental costs, the profits passed through the tracker will be lower. If Kentucky Power believes it prudent and appropriate to adjust its base rates, its remedy must be pursued through a general rate application under KRS 278.190, not a challenge to its environmental surcharge.

Kentucky Power asserted that the Commission's Order unlawfully trapped some environmental costs which can never be recovered. Costs are "trapped" if

they are properly allocated to a state jurisdiction but the state refuses to allow recovery through any rate mechanism and the costs then become caught between FERC and state regulation and therefore are unrecoverable in any jurisdiction. See Nantahala Power & Light v. Thornburg, 106 S.Ct. 2349 (1986).

That is certainly not the case here.

Because 98.6% of environmental costs are not the responsibility of Kentucky ratepayers, the fact that Kentucky ratepayers do not pay that percentage is simply proper ratemaking. There is no trapping when costs are allocated to the cost causer. The allocation of costs between retail and wholesale sales is a standard function of the Commission in every base rate, fuel adjustment and environmental surcharge rate proceeding. When that allocation is cost justified, as it is here, then nothing is trapped.

All parties agree that some allocation of environmental costs to wholesale sales is appropriate. Kentucky Power's only dispute is with the Commission's judgment regarding the level of that allocation. However, the Commission's judgment on this issue is not arbitrary and is clearly based on substantial evidence.

EXHIBIT ____ (LK-5)



[\[Go To Best Hit\]](#)

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COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE)
COMMISSION OF THE ENVIRONMENTAL)
SURCHARGE MECHANISM OF KENTUCKY)
POWER COMPANY D/B/A AMERICAN ELECTRIC) CASE NO.
POWER FOR THE SIX-MONTH BILLING PERIODS) 2000-107
ENDING DECEMBER 31, 1998 AND)
DECEMBER 31, 1999, AND FOR THE TWO-YEAR)
BILLING PERIOD ENDING JUNE 30, 1999)

O R D E R

On March 14, 2000, the Commission initiated two 6-month reviews and one 2-year review of Kentucky Power Company d/b/a American Electric Power's ("Kentucky Power") **environmental surcharge** as billed to customers for the following periods: the 6-month periods (a) July 1, 1998 to December 31, 1998; (b) July 1, 1999 to December 31, 1999; and (c) the 2-year period July 1, 1997 to June 30, 1999. Since Kentucky Power's surcharge is billed on a 2-month lag, the amounts billed from July 1998 through December 1998 are based on costs incurred from May 1998 through October 1998; amounts billed from July 1999 through December 1999 are based on costs incurred from May 1999 through October 1999; and amounts billed from July 1997 through June 1999 are based on costs incurred from May 1997 through April 1999.

Pursuant to KRS 278.183(3), the Commission must review, at 6-month intervals, the past operations of the **surcharge** and, after hearing, disallow any **surcharge** amounts that are not just and reasonable and reconcile past **surcharge** collections with actual costs recoverable. At 2-year intervals, the Commission must review and evaluate the past operations of the **environmental surcharge** and, after hearing, disallow improper expenses and, to the extent appropriate, incorporate **surcharge** amounts found just and reasonable into the existing base rates of the utility.

Kentucky Power generates, transmits, and distributes electric power to over 170,000 customers in 20 counties in eastern Kentucky. Kentucky Power is a wholly owned subsidiary of the American Electric Power Company ("AEP"), a registered public utility holding company. Kentucky Power, along with its four affiliates that operate in other states, are all members of an interstate power pool, commonly known

as the AEP Power Pool. Transactions among the members are governed by the AEP Pool Agreement, which allocates certain revenues and expenses associated with wholesale sales of power. This Agreement is subject to the exclusive regulatory jurisdiction of the Federal Energy Regulatory Commission ("FERC").

In anticipation that those parties to Kentucky Power's last 6-month review would desire to participate in this proceeding, the Attorney General's office ("AG") and the Kentucky Industrial Utility Customers, Inc. ("KIUC") were deemed parties to this proceeding. A public hearing was held on July 18, 2000, and all information requested during the hearing has been filed. Briefs were filed on August 22, 2000.

JURISDICTIONAL ALLOCATION

Kentucky Power contends that its experience in implementing the surcharge demonstrates that using the approved revenue-based allocation methodology ("revenue method") does not permit it to recover all of its environmental costs and does not properly allocate its environmental costs to the appropriate cost-causers. Kentucky Power believes that a more appropriate methodology would allocate fixed environmental costs on a demand basis and variable environmental costs on an energy basis ("demand and energy method"), consistent with Kentucky Power's retail System Sales Clause ("Sales Clause"). Kentucky Power notes that while the revenue method may have originally appeared reasonable, due to circumstances unique to Kentucky Power, that methodology has not produced the desired or required results. Kentucky Power Brief at 2, 3, and 9.

Kentucky Power lists three of these circumstances. First, Kentucky Power notes it has many wholesale sales that do not use AEP facilities and these sales produce what Kentucky Power identifies as "non-physical" revenues. These non-physical revenues were originally included in the calculation of the jurisdictional allocations under the revenue method, but after several months, they were eliminated from the calculation by agreement of the parties and Commission Staff. Second, Kentucky Power believes that the revenue method is an imprecise measure for environmental cost allocation purposes. Kentucky Power states that for the 12-month period ending June 2000, retail customers paid for 75.5 percent of its environmental costs while no recovery was received for the remaining 24.5 percent. Finally, Kentucky Power argues that the environmental facilities were constructed and costs incurred to meet its retail customers' demand, thus its retail customers should bear the costs as directed under KRS 278.183. *Id.* at 3-4.

Kentucky Power extensively argues against the use of the revenue method by contrasting it with its Sales Clause. The Sales Clause, approved by the Commission in 1988, was designed to share profits from Kentucky Power's off-system sales with retail ratepayers. Kentucky Power states that the rationale behind the Sales Clause is that since the ratepayers are paying for the fixed costs of the units generating sales off-system, ratepayers should share in the profits received from those sales. Kentucky Power's base rates recognize a historic level of profit from off-system sales. Periodically, Kentucky Power's non-base rates increase or decrease to reflect one-half of the difference between the current level of profit and the historic level of profit. Kentucky Power claims that the revenue method used in the environmental surcharge does not recognize the effect of the Sales Clause on it or its ratepayers. Kentucky Power believes that environmental costs assigned by the revenue method to off-system sales customers are not totally recovered from those customers because the system sales profits used to calculate the Sales Clause are based on "out-of-pocket" costs. Out-of-pocket costs include all operating, maintenance, tax, transmission losses, losses that would not have been incurred if the power and energy had not been supplied for such deliveries, including demand and energy charges for power and energy supplied by third parties. See Kentucky Power Brief at 10, footnote 6.

Kentucky Power argues that while the environmental surcharge costs allocated under the revenue method to off-system sales customers are composed of fixed and variable costs, in essence only the variable costs can be recognized in the Sales Clause calculations. Therefore, Kentucky Power claims the

remaining fixed environmental costs are unrecovered. Kentucky Power Brief at 9-10.

Kentucky Power further argues that the revenue method creates an inconsistency by accepting costs from the AEP Power Pool based on the Pool Agreement, while deviating from the Pool Agreement for the surcharge by allocating costs back to the AEP Power Pool on a percentage of revenue basis. Kentucky Power contends that consistency and equity require that costs to and from Kentucky Power should be on a fully-distributed basis, rather than on an average embedded basis that is lower. Kentucky Power believes that the environmental surcharge, the Sales Clause, and the Pool Agreement should all follow the same cost allocation methodology. Kentucky Power further believes that equity requires that the other AEP operating companies should not be allocated any of its fixed environmental costs since Kentucky Power is not a capacity surplus company. Kentucky Power claims that it and its ratepayers do not pay any fixed environmental investment cost on purchases from non-surplus AEP companies. *Id.* at 9, footnote 5.

KIUC opposes Kentucky Power's proposal to use a demand and energy method and supports the continued use of the revenue method for allocating the environmental costs between retail customers subject to this Commission's jurisdiction and wholesale customers who are non-jurisdictional. KIUC notes that Kentucky Power neither filed testimony on this issue nor produced a current cost-of-service study in support of its position. KIUC argues that a total revenue allocation factor recognizes that environmental compliance costs include both fixed and variable costs and that some pollution is caused through the generation of electricity regardless of who the ultimate customer is. KIUC states that Kentucky Power seeks to completely disregard the Commission's decision to adopt the revenue method in Case No. 96-489 Case No. 96-489, Application of Kentucky Power Company d/b/a American Electric Power to Assess a Surcharge Under KRS 278.183 to Recover Costs of Compliance with the Clean Air Act and Those Environmental Requirements Which Apply to Coal Combustion Waste and By-Products, final Order dated May 27, 1997; rehearing Order dated July 8, 1997.

and the April 30, 1998 Opinion and Order of the Franklin Circuit Court affirming that decision. *Commonwealth of Kentucky v. Kentucky Public Service Commission*, Franklin Circuit Court, Consolidated Case Nos. 97-CI-114, 97-CI-01138, and 97-CI-01319, April 30, 1998.

KIUC contends that the Franklin Circuit Court previously rejected the same arguments that Kentucky Power has raised in this proceeding. KIUC states Kentucky Power's argument that the majority of its environmental costs are fixed, or demand, related and should be assigned to Kentucky ratepayers is erroneous. KIUC points to data responses from Kentucky Power that indicate approximately 73.13 percent of its environmental costs are variable, or energy, related. KIUC also points to financial data that shows Kentucky Power's off-system sales account for approximately 40 percent of its total sales. KIUC concludes that these facts support the continued use of the revenue method, which helps to ensure that Kentucky ratepayers do not subsidize the cost of Kentucky Power's off-system sales. KIUC Brief at 1-4 and 6-8.

In his brief, the AG contends that Kentucky Power has presented exactly the same arguments that were advanced and rejected in Case No. 96-489. The AG notes that the Commission carefully considered and addressed each argument in that case, and concluded that the revenue method was the most appropriate allocation approach. The AG further notes that the Franklin Circuit Court affirmed the Commission's decision to adopt a revenue allocation rather than a demand and energy allocation. The AG concludes that the record now before the Commission contains nothing that warrants the change proposed by Kentucky Power. AG Post-Hearing Brief at 4-5.

When the Commission opened this environmental surcharge review, the procedural schedule directed Kentucky Power to file by April 13, 2000 any prepared direct testimony in support of the reasonableness of the application of its environmental surcharge mechanism during the three periods under review. March 14, 2000 Order, ordering paragraph number 4.

Kentucky Power chose not to file any prepared direct testimony concerning its surcharge. While Kentucky Power has responded to information requests See Response to the Commission's March 14, 2000 Order, Item 24 and Response to the Commission's May 1, 2000 Order, Item 9.

and answered questions at the public hearing concerning the jurisdictional allocation issue, it waited to provide its most extensive and thorough explanations and arguments in its post-hearing brief. The Commission recognizes that this tactic may have short-circuited the discovery and cross-examination which was contemplated by the procedural schedule. However, since Kentucky Power presented no argument that was not presented and rejected in Case No. 96-489, we do not believe any party suffered any prejudice.

The Commission fully recognizes Kentucky Power's membership in a multistate holding company and the impacts of the AEP Pool Agreement. While the allocation methodologies under the AEP Pool Agreement are subject to FERC's exclusive jurisdiction, the environmental surcharge is under our exclusive jurisdiction. Under KRS Chapter 278, and specifically KRS 278.183, this Commission is obligated to establish reasonable jurisdictional allocation methods that minimize the risk of Kentucky ratepayers subsidizing the costs of power sold to wholesale customers.

Kentucky Power's membership in the AEP system provides no valid basis to change from the revenue method established to allocate Kentucky Power's environmental costs under the surcharge. Kentucky Power's non-physical revenues are no longer an issue in the surcharge calculation and, thus, do not justify abandoning the revenue method. Kentucky Power began receiving non-physical revenues in July 1997 and became aware of the impact those revenues were having on the jurisdictional allocations in April 1998. See Case No. 98-624, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Power Company d/b/a American Electric Power as Billed from January 1, 1998 to June 30, 1998, Response to the Commission's December 21, 1998 Order, Item 9, pages 1 through 6 of 7.

Kentucky Power contacted Commission Staff about this situation, and after a September 1998 informal conference with the parties, Kentucky Power was permitted to exclude non-physical revenues from the revenue method calculations. See Kentucky Power Monthly Environmental Surcharge Report, transmittal letter dated September 18, 1998.

This exclusion began with the October 1998 billing month. The surcharge amounts billed in October 1998 were based on expenses for the month of August 1998.

and has continued to date. Thus, the exclusion of Kentucky Power's non-physical revenues from the revenue method calculations eliminates those revenues as a reason to change allocation approaches. This exclusion of non-physical revenues was not addressed in the Commission's July 15, 1999 Order in Case No. 98-624, because the exclusion was implicitly recognized in the settlement agreement approved by the Commission in Case No. 99-149. Case No. 99-149, Joint Application of Kentucky Power Company, American Electric Power Company, Inc. and Central and South West Corporation Regarding a Proposed Merger, final Order dated June 14, 1999. Under the terms of the settlement agreement, the parties agreed there would be no adjustment to the environmental surcharge for the period under review in Case No. 98-624.

The Commission has reviewed the record in Case No. 98-624, as well as the information contained in the periods under review in this proceeding, and finds that the implicit exclusion of non-physical revenues from the determination of the jurisdictional allocation factor should be recognized explicitly in

this case.

The Commission is not persuaded by Kentucky Power's claim that it has not recovered its environmental costs allocated to off-system sales under the revenue method. Kentucky Power contends that for the 12-months ending June 2000 it received no recovery for 24.5 percent of its fixed environmental costs. Kentucky Power assumes that because the fixed component of environmental costs allocated to off-system sales is not recognized in its Sales Clause calculation, the fixed cost component must not have been recovered. Kentucky Power provided no analysis of its gross and net margins from off-system sales to demonstrate that these allocated environmental costs have not been recovered. Absent evidence to support this position, such as an analysis of the margins achieved from off-system sales, the Commission cannot accept Kentucky Power's unsupported assumption. However, assuming that Kentucky Power is not recovering its fixed environmental costs on its wholesale sales, one obvious reason would be because its wholesale sales are priced below cost. The remedy for this problem is not to pass the wholesale costs to retail ratepayers through the environmental surcharge. Thus, this circumstance does not warrant a change from the use of the revenue method to determine the jurisdictional allocation of environmental costs.

In Case No. 96-489, the Commission was presented with Kentucky Power's proposal to allocate 98.6 percent of fixed environmental costs to retail ratepayers on the basis of peak demand, and KIUC's proposal to allocate 83 percent to retail ratepayers based on total revenues. The evidence in that case showed that only 64 percent of the energy produced by Kentucky Power was sold to retail customers, while 36 percent was sold to wholesale customers. Finding that the environmental costs should be assigned to the cost-causer, the Commission followed its established precedent in adopting a revenue-based allocation. On appeal, the Franklin Circuit Court affirmed the Commission's allocation of 83 percent of environmental costs to retail ratepayers based on a revenue allocation. *Commonwealth of Kentucky v. Public Service Commission* at 19.

The Court specifically ruled that, "Because Kentucky Power's system is currently operated to supply wholesale sales for resale, a representative cost allocation must be made to these sales." *Id.*

Now, Kentucky Power proposes to allocate 99.6 percent of fixed environmental costs to retail ratepayers based on the same peak demand allocation previously rejected. In support of its proposal, Kentucky Power argues that neither the prior decisions of the Commission nor the Franklin Circuit Court are binding precedent because there has been a change in circumstances since those prior decisions were issued. The change in circumstances, according to Kentucky Power, is that it now has actual experience under the revenue allocation. That experience allegedly shows retail ratepayers paying for 75.5 percent of environmental costs, while the remaining 24.5 percent are unrecovered.

An analysis of the evidence in this case indicates stark similarities to that in Case No. 96-489. Here, for the 12 months ending June 2000, over 42 percent of the energy produced by Kentucky Power was sold to wholesale customers, while over 25 percent of its revenues from physical sales came from wholesale customers. Kentucky Power Information Response, Item 5, filed August 22, 2000.

This clearly demonstrates that Kentucky Power is continuing to produce substantial quantities of power for wholesale customers. While Kentucky Power accurately notes that based on revenues, retail ratepayers are only paying for 75 percent of environmental costs, it provided no analysis to demonstrate that the remaining 25 percent of environmental costs were not being recovered. Further, even assuming that 25 percent of the costs are not being recovered, the issue previously decided was that retail ratepayers should not pay for all environmental costs incurred to make wholesale sales. Thus, the Commission adopted, and the Circuit Court affirmed, the use of a revenue allocation. Costs properly allocable to wholesale customers cannot, and must not, be reallocated to retail customers merely because such costs are not being recovered from wholesale customers. Reallocating such costs to retail customers violates the principle that costs be allocated to the cost-causer.

As for Kentucky Power's last claim, the Commission has previously rejected the argument by Kentucky Power that its environmental facilities and associated costs were constructed and incurred to meet the

demands of its Kentucky ratepayers only, and those ratepayers should bear virtually all the costs. In fact, Kentucky Power constructed its environmental facilities and incurs environmental costs in order for it to comply with the environmental laws and regulations applicable to the generation of electricity. These compliance actions must take place regardless of whether the electricity generated is sold to Kentucky ratepayers, to the AEP Power Pool, or to make other wholesale sales. The Commission is not persuaded by Kentucky Power's argument that its Kentucky jurisdictional customers are the only environmental cost-causers. The sales of its generation properly identify the cost-causers of Kentucky Power's environmental costs. In this proceeding, Kentucky Power has offered no compelling evidence to change the Commission's prior decision.

The existence and operation of Kentucky Power's Sales Clause also does not justify changing the jurisdictional allocation approach from the revenue method. As discussed previously in this Order, Kentucky Power has provided no analysis of its gross and net margins on off-system sales to demonstrate its claimed lack of recovery of environmental costs allocated to off-system sales. Further, Kentucky Power has provided no analysis showing the impact on the Sales Clause if the fixed environmental costs allocated to off-system sales were recognized in the Sales Clause calculations. Kentucky Power's Sales Clause was the result of a 1988 settlement agreement resolving litigation related to an earlier Kentucky Power general rate case. If the off-system sales profits are misstated because the current Sales Clause does not provide for the recognition of fixed environmental costs, then it is the Sales Clause which needs modification, and not the jurisdictional allocation approach used to assign environmental costs.

The Commission is not persuaded by Kentucky Power's arguments that the use of the revenue method creates an inconsistency with the costing provisions of the AEP Pool Agreement. Because of the requirements of the AEP Pool Agreement, the environmental surcharge mechanism does include costs associated with AEP's Rockport, Indiana and Gavin, Ohio generating units. However, the AEP Pool Agreement does not dictate how the Commission allocates the environmental costs to retail ratepayers under the surcharge mechanism.

Kentucky Power's contention that no other AEP operating company should be allocated any of its fixed environmental costs because Kentucky Power is not a capacity surplus company is irrelevant. This Commission has exclusive jurisdiction over Kentucky Power's retail rates, including its environmental surcharge. Kentucky Power's fixed and variable environmental costs must be allocated to the appropriate cost-causer. To the extent that Kentucky Power makes sales to other AEP affiliates, it is clearly inappropriate for the environmental costs associated with those sales to be recovered through a surcharge on Kentucky retail ratepayers, regardless of whether Kentucky Power is a surplus member of the AEP power pool. While Kentucky Power claims that it pays no fixed environmental costs on purchases from AEP non-surplus members, Kentucky Power has provided no analysis of the costs incorporated in the price it pays for purchases from any other AEP operating company, whether surplus or non-surplus.

The Commission finds that none of the arguments offered by Kentucky Power support a change in the jurisdictional allocation approach and, therefore, the revenue method should continue to be utilized. We agree with the AG that Kentucky Power's arguments concerning the appropriate cost-causer are essentially the same as it presented, and the Commission considered and rejected, in Case No. 96-489. Kentucky Power's concerns over the interaction of the environmental surcharge mechanism with its Sales Clause indicate that if there is a problem, it lies within the Sales Clause and does not constitute justification for a change in the allocation approach. We further agree with the arguments of KIUC, which notes that significant levels of Kentucky Power's sales are made to off-system customers. Under these conditions, it is neither appropriate nor reasonable to allocate a greater share of Kentucky Power's environmental costs to its jurisdictional ratepayers, and in effect subsidize off-system sales customers.

SURCHARGE ROLL-IN

In response to a data request, Kentucky Power calculates that an increase of \$7,707,584 should be incorporated into its existing base rates pursuant to KRS 278.183(3). Response to the Commission's March 14, 2000 Order, Item 23. The incorporation of a portion of the environmental surcharge into